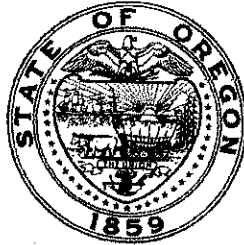


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**Testimony to the
Senate Finance and Revenue Committee
Keith Larson, Chairman of the Oregon Investment Council**

March 11, 2013

For the record, I am Keith Larson, and I'm speaking before you today in my capacity as Chair of the Oregon Investment Council. I would like to thank the committee for taking the time to learn about the Investment Modernization and Cost Reduction Act (Senate Bill 120). I have over 27 years of experience in the investment business. I'm currently a vice president of Intel Capital, Intel's global investment organization, where I have worked for the last 16 years. Just last month Intel Capital was recognized as the #1 technology venture capital investor out of the top 20 firms for M&A exits in 2012 (source: PrivCo). Intel Capital has invested over \$10.8B in 54 countries since 1996 and had more than 500 IPO's and acquisitions. I am a former CPA and previously held a Series 7 securities license.

I'm giving you this background to help you understand that while the Investment Council is made up of appointed citizens, it requires individuals with solid acumen in investing and is responsible for keeping Oregon's investment house in order.

The Investment Council guides the investment policies for more than \$80 billion in public trust funds, including the State Accident Insurance Fund, the Oregon Common School Fund and the Public Employees Retirement Fund. The Investment Council takes a hard look at newly proposed investments, how much those investments cost and whether they are prudent for the long-term. The returns have been solid, and Oregon consistently performs better than many of peers. In fact, we learned last month that, for the Oregon Public Employees Retirement Fund, we had the best returns in the country among public funds greater than \$1 billion in size, for not just the past year, but also for the past 3- and 10-year periods. That is outstanding, and it is helping to improve Oregon's economic condition.

Oregon has been recognized as a leader in investment management for many years. However, to sustain leadership requires vigilance and continuous improvement. So in spite of our success, we reviewed some of the program's fundamental underpinnings. And it was jarring for us to learn that Oregon's investment house is actually sitting on a foundation that is not aligned with our fiduciary duties.

Senate Bill 120 will help to shore up those deficiencies, and allow Oregon to move forward more safely in an investment landscape that is more complex and has more pitfalls than ever before.

Beginning 16 months ago with the departure of the State Treasury's previous Chief Investment Officer, we began a process of reviewing our business model and governance structure to promote continuous improvement. We brought in professionals to advise us on best practices around the country and around the world. We requested an internal audit. What we found was striking.

- The lines of accountability are blurred because the Investment Council, though able to set investment policy, is not actually able to direct staff.
- Oregon's cost structure is disproportionately high because of the heavy reliance on external investment managers.
- And critically, Oregon has only a fraction of the risk management and protection functions that are commonplace for managers of similarly-sized portfolios.

Senate Bill 120 is a reflection that -- while the investment world has changed markedly in the past three decades -- Oregon's investment program has not kept pace. And as consultants told us, the portfolio could face significant risks if we fail to modernize and strengthen the management of it. At the same time, we would be able to save potentially hundreds of millions of dollars in taxpayer money over the coming years if we can stop outsourcing significant parts of our investment management. While external money managers can bring significant value to certain strategies within a portfolio, our heavy reliance on Wall Street is more of a necessity than a choice under the current structure.

SB 120 will provide that the fiduciary and management responsibilities of the investment portfolios are aligned. It will allow for better, more proactive and thoughtful risk and operations management.

This Legislation makes this possible by converting the Investment Council to a public corporation, the Oregon Investment Corporation ('OIC'). As a public corporation, the OIC will have the flexibility to manage the State's investment program like the professional investment organization management of an \$80 billion portfolio warrants. The staff of the corporation will report to the OIC's board, rather than to just one member.

This alignment of fiduciary duty and management responsibility will allow the OIC to ensure that the organization is sufficiently resourced to carry out the policy goals we set. It will allow us to address functional weaknesses in the organization such as the lack of a dedicated risk management program, inadequate regulatory and transactional compliance, and in-house research support. It will enable us to maximize the value from our investment professionals, by more appropriately apportioning workload. In essence, it will enable us to do it right.

Currently, the Investment Council takes a hard look at how much is spent on external management, and has won industry-wide accolades for driving a hard bargain and getting good value for less. But we could do better. Under SB 120, the board of the OIC would gain budgetary authority and be able to scrutinize the costs of the entire program -- inside and out -- and make resourcing decisions that are both prudent and maximize long-term value creation.

SB 120 is a priority for the Oregon Investment Council, and we unanimously support it. That said, we would not be here before you today if it wasn't for the support and commitment of the Treasurer, in his roles as both a state officer and a Council member. This is fortunate since under current law, staffing and support for the OIC is not required to be provided by the Treasurer's office.

All Oregonians have a stake in the wise management of public trust fund assets. SB120 places management authority in the hands of those charged with fiduciary oversight, a fundamental best practice in investment fund management. It is critical to keeping our investment house in order, and to building a stronger foundation for the long-term.

Thank you for your time and I would be happy to answer any questions I can.

SENATE BILL 120 (with 120-3 amendments)**INVESTMENT MODERNIZATION AND COST REDUCTION ACT****Background**

The Investment Modernization and Cost Reduction Act (SB 120) is a money-saving reform that will keep more Oregon investment dollars in Oregon and improve investment management. The Act will:

- Allow for improved portfolio management by bringing more monitoring functions in-house,
- Address long-term management issues by clarifying and modernizing the staff structure,
- Provide immediate cost savings compared to current expenses, and
- Yield long-term savings to the Public Employees Retirement System

Room for Improvement

The current structure of Oregon's investment program is largely a creation of 1970s statutes. But as the investment world has evolved to become more complex and nimble, Oregon's model has failed to keep pace.

This structure vests hiring authority over the investment staff in the State Treasurer, financing authority in the Legislature, and responsibility over the investments in the Oregon Investment Council (OIC). This structure has produced a system that relies greatly on out of state third-party services. Although Treasury aggressively negotiated relatively low fees for these services, this heavily-outsourced model is ultimately more costly to the state than alternative models. Enabling more internal management by investing in investment division resources will ultimately be less costly and likely result in improved investment performance.

Changes

The Investment Modernization and Cost Reduction Act asks for broad changes in the legal relationship between the Oregon Investment Council and the State's investment staff, but maintains associated oversight, transparency, and disclosure rules associated with state investments. The Act will:

1. Re-establish the Oregon Investment Council as a quasi-public agency
 - Similar to other such agencies
 - Council and appointment process remains the same (but the potential of increasing board membership will be discussed in 2014)
 - OIC becomes a governing "board" of the new agency
 - Appropriations are unchanged, but the OIC Board is not expected to bring an expenditure limitation bill to the Legislature each biennium
 - Legislature retains ultimate oversight
2. Move the State Treasurer's Investment Division under the re-established OIC
 - Investment staff will report to OIC Board as a whole, NOT to the Treasurer alone
 - OIC Board will have hiring/firing authority
 - Staff are still considered "State employees"

3. Make various conforming changes

New OIC will be subject to same ethics, reporting, disclosure, personnel, and investment regulations as is the current OIC

Item	Currently (Treasury Investment Division)	Changes Under New Model
Investment staff	Answer to the State Treasurer only	Answer to the OIC
Budget sources	No tax dollars; uses investment returns	No change
Budgeting authority	Continuous appropriations	No change
Budgeting process	Biennial expenditure limitation bill	Internal process at public meeting
Disclosure	Limited exemptions for investments	No change
Ethics: Reporting	Various SEI and quarterly reporting	No change
Ethics: "Gifts"	Limited exemptions for official business	No change
OIC/Board	Governor appoints / Senate confirms	No change
Investment standards	Outlined in ORS 293	No change

Benefits

Allow for improved portfolio management by bringing more monitoring functions in-house

Some investment functions, particularly risk management, are outsourced to third party contractors. The Act will give the OIC the personnel authority to bring establish these positions locally and better integrate these services with Oregon's investment programs and existing staff. The OIC will be flexible enough to make these decisions through existing continuous appropriations without awaiting a Legislative Session. However, the Legislature retains the ability to trump any such decision.

Address long-term management issues by clarifying and modernizing the staff structure

Currently, the OIC relies on staff that report to only one of its members: the State Treasurer. (This would be akin to all Legislative offices relying on staff that only answered to a single Legislator.) The Act fixes this disconnect by moving to a structure in which staff reports to the OIC as a whole.

Provide immediate cost savings compared to current expenses

Staff have identified short-term cost savings of about \$12 million per year that would be the result of out of state contracts giving way to in-house positions. A third party consultant has independently identified additional cost savings that total \$90 million per year.

Yield long-term liability savings to the Public Employees Retirement System

Short term savings are realized directly by the Public Employees Retirement Fund itself, thereby adding to returns and ultimately lowering the reliance on taxpayer-financed employer contributions to meet obligations. Savings will also earn returns over time, multiplying the impact year after year.

Summary

The Investment Modernization and Cost Reduction Act will:

- Retain existing legislative and public oversight,
- Modernize and rationalize the staffing structure surrounding Oregon's investments,
- Enhance services and monitoring, and
- Reduce system costs

SENATE BILL 120 (as amended by 120-3)**INVESTMENT MODERNIZATION AND COST REDUCTION ACT****Section-by-Section:**

Sec.	ORS	Action	Notes
1		Numbers Sections 2-9 into ORS 293.	
2	293	Establishes the Oregon Investment Corporation (OIC). Gives the OIC various investment, personnel, and contracting authorities.	
2a	293	Authorizes the State Treasurer to continue managing Oregon Short Term Fund (OSTF) with current powers, and to choose to allow OIC to manage OSTF.	OSTF management is substantially a Cash Management function of the State Treasury.
3	293	Establishes Board of Directors for OIC ("Board"). Consists of Treasurer and four gubernatorial appointments. Director of PERS sits on the Board as a non-voting member.	This replaces current Oregon Investment Council (ORS 293.706). Terms of board makeup and appointment are the same except that term limits are not included in order to conform to proposed SB 16.
4	293	Describes powers and responsibilities of OIC Board. Outlines productivity objective; fiduciary standards. Requires Board to adopt personnel policies. Requires Board to adopt a code of ethics. Provides for transfer of Treasury employees to OIC.	
4(5)	293	Authorizes Board to adopt a budget (at a public meeting) and clarifies that Board is not required to seek approval from Legislature to spend appropriated money. Statement of revenues and expenses must be prepared annually and made publicly available.	No change in appropriation treatment; investment staff budget is already continuously appropriated.
4(6-8)	293	Allows Board to contract for shared services with state agencies and provide services to other governmental entities. Broadens audit authority of the Board.	
5	293	Board is authorized to require a fingerprint check of certain current or prospective employees.	
6	293	Requires the Board to hire an Executive Director with powers necessary to carry out duties of the OIC. Requires a fidelity bond of \$50,000, paid by the OIC.	The State Treasurer is required to post a fidelity bond of \$200,000. The Director of DAS sets the amount with \$50,000 the minimum.

7	293	Clarifies that employees of the OIC: <ul style="list-style-type: none"> - Participate in PERS. - May bargain collectively. - Are eligible to receive same benefits, etc as State employees otherwise. 	Allows hire dates, accrued leave, etc. to move to corporation with employees.
8	293	General applicability of various ORS sections to OIC.	All applications are as described unless otherwise provided for.
8(1)	293	Exempts OIC from ORS 184.360.	DAS audit rules (Although audits are still required of the OIC per Section 24).
		Exempts OIC from ORS 279.835 to 855.	Public contracting code.
		Exempts OIC from ORS 182.	Executive administration
		Exempts OIC from ORS 240.	State employment generally.
		Exempts OIC from ORS 270.	Real property ownership by state entities.
		Exempts OIC from ORS 273.	Guidelines relating to public lands.
		Exempts OIC from ORS 276.	Facilities and insurance.
		Exempts OIC from ORS 279A, B, and C.	Public contracting code (OIC is already mostly exempt).
		Exempts OIC from ORS 282.	Public printing processes.
		Exempts OIC from ORS 283.	Public facilities rules.
		Exempts OIC from ORS 291.	State financial administration; DAS.
		Exempts OIC from ORS 292.	State salaries.
		Exempts OIC from ORS 293.	Public funds; much of this section is re-applied elsewhere in the bill.
8(2)	293	Applies ORS 182.100 to OIC.	Affirmative action.
		Applies ORS 182.109 to OIC.	ADA compliance.
		Applies ORS 240.167 to OIC.	Employee Relations Board assessment.
		Applies ORS 279A.100 to OIC.	Allows OIC to promote contracts for minorities, women, and small businesses.
		Applies ORS 292.043 – 044 to OIC.	Paycheck deductions.
		Applies ORS 293.115 to OIC.	Description of funds separate from general fund.
		Applies ORS 293.117 to OIC.	Trust funds.
		Applies ORS 293.130 to OIC.	Requirement of Treasurer relative to accounting for deposited moneys. Would be applicable to moneys deposited by the OIC in Treasury.
		Applies ORS 293.169 to OIC.	Banking controls of Treasurer applicable to OIC funds on deposit with Treasurer.
		Applies ORS 293.171 to OIC.	Overdrafts.
		Applies ORS 293.205-225 to OIC.	Interfund borrowing statutes.
		Applies ORS 293.250, 265-280, 285 to OIC.	Cash handling.
		Applies ORS 293.295 to OIC.	Paying claims.
		Applies ORS 293 sections to OIC.	Cash management generally.
		Applies ORS 293.701-820 to OIC.	Investment of state funds.
		Applies ORS 293.875 to OIC.	State Treasurer as cash management officer.
		Applies ORS 293.880 to OIC.	Creation of subaccounts relative to Federal cash management directives.
		Applies ORS 293.990 to OIC	Class A misdemeanor for violations

8(3-4)	293	Clarifies independent status of OIC and applicability of Oregon Tort Claims Act and public body insurance	
9	293	Creates Oregon Investment Corporation Fund as an operating account for the OIC. Money in the fund is continuously appropriated to the OIC for expenses of the OIC.	The Treasury currently operates similarly from the Miscellaneous Receipts Account.
10		Numbers Section 11 into ORS 192.	Technical drafting instructions
11	192	Maintains that Treasurer may remain arbiter of public records requests. Clarifies that as in current law, denials by Treasurer as a board member and elected official would be appealed to the circuit court, not to the Attorney General. Unless Treasurer asserts discretion, denials may be appealed to the Attorney General.	This maintains current practices on investment records, since the State Treasurer (as custodian of those records) is an elected official. Court's power is outlined in Section 37.
12	293.701	Housekeeping name changes.	Statutory references will need to change "Oregon Investment Council" to "Oregon Investment Corporation".
13	293.711	Housekeeping name changes, and allowing the OIC chair to serve 6 years instead of 4.	
14	293.714	Housekeeping name changes.	Existing statute requires public recordkeeping of OIC meetings. This practice is unchanged.
15	293.718	Fund management expenses that currently flow to Treasury are instead diverted to the OIC's operations fund. Clarifies that OSTF management is still a function of State Treasury and assesses fees accordingly.	The receiving fund is created in Section 9 of the bill.
16	293.726	Clarifies that OIC may manage OSTF at request of State Treasurer. Applies "prudent investor standard." Also contains housekeeping name changes and clarifications.	Broadens law slightly to allow for investment of moneys not enumerated in list of investment funds.
17	293.728	Outlines how interest rates applicable to OSTF transfers are determined.	
18	293.733	Housekeeping name changes.	Existing statute concerns venture capital investments in Oregon. No substantive changes. (Section 19 is identical to Section 18 and provides for possible changes in statute.)
19	293.733		
20	293.734	Housekeeping name changes. Adds Governor to list of report recipients.	
21	293.746	Housekeeping name changes. Cleanup of superfluous statutes.	
22	293.751	Housekeeping name changes. Cleanup of superfluous statutes. Clarifies that Treasurer holds title instruments for OSTF investments.	
23	293.771	Housekeeping name changes.	Existing statute requires biennial reports describing investments. No substantive changes.

24	293.776	Directs corporation to establish an internal audit function.	Maintains audit as public record.
25	293.778	Housekeeping name changes.	Authorizes establishment of holding companies.
26	293.790	Housekeeping name changes.	Authorizes disposition of donated or bequeathed stock.
27	293.793	Housekeeping name changes.	Re: Purchase of state bonds.
28	293.796	Housekeeping name changes.	Findings related to the availability of start-up capital.
29	293.796		
30	293.812	Name changes. Adjusts Sudan divestment program in order to comply with federal law (mirrors Iran divestment program).	Existing Sudan Divestment program. These changes conform the bill to provisions of Senate Bill 17 (2013) so there is no conflict if both pass.
31	293.814		
32	293.815		
33	293.817		
34	293.820	Housekeeping name changes.	Accounting for local government investments.
35	30.260	Lists the corporation as a part of the State for purposes of the Oregon Tort Claims Act.	
36	173.500	Housekeeping name changes.	State Capitol Foundation reporting.
37	192.490	Allows court to order OIC to produce certain records improperly withheld.	Refers to process outlined in Section 11.
38	192.502	Housekeeping name changes.	Public records exceptions. No substantive changes.
39	238A.050	Housekeeping name changes.	PERS investments.
40	243.401	Housekeeping name changes.	Deferred Compensation definitions.
41	243.421	Housekeeping name changes.	Deferred Compensation program and administration.
42	243.426	Housekeeping name changes.	
43	243.472	Housekeeping name changes.	
44	243.474	Housekeeping name changes.	
45	243.476	Housekeeping name changes.	
46	243.478	Housekeeping name changes.	
47	243.482	Housekeeping name changes.	
48	244.045	Housekeeping name changes; clarifying language allowing Treasury investment officers to become employed by the OIC without running afoul of ethics rules.	Current law prevents investment officers from being employed by certain new employers within two years of leaving Treasury, but did not anticipate a transfer to a successor agency of the OIC.
49	244.047	Clarifying language allowing Treasury investment officers to become employed by the OIC without running afoul of ethics rules.	
50	244.050	Adds new OIC Board and Executive Director to list of individuals required to complete Statement of Economic Interest.	(Section 51 is identical to Section 50 and provides for possible changes in statute relative to Oregon Growth Board.).
51	244.050		
52	244.050	Makes current financial disclosure for Treasury staff applicable to Corporation staff.	Treasury investment officers already file this disclosure through rule; this section codifies that requirement in statute. Maintains reporting with Attorney General and Secretary of State.
53	293.708	Conforming changes.	Regards the reporting of possible conflicts of interest by Board members.
54	246.590	Conforming changes.	Authority to make voting machine loans.
55	273.413	Housekeeping name changes.	Consultations with Dept of State Lands.

56	276.013	Housekeeping name changes.	Loans to DAS.
57	276.015	Housekeeping name changes.	Limits on investments made pursuant to
58	276.110	Conforming changes.	ORS 276.013.
59	286A.145	Conforming changes.	Bond covenants.
60	<i>No Section 60; subsequent sections not renumbered.</i>		
61	294.035	Housekeeping name changes.	Investments by local government entities.
62	294.805	Housekeeping name changes.	Local Government Investment Pool. Allows for investment either by the Treasurer or the Corporation (like the OSTF).
63	<i>No Section 63; subsequent sections not renumbered.</i>		
64	<i>No Section 64; subsequent sections not renumbered.</i>		
65	294.820	Housekeeping name changes.	Addition of various definitions and clarification that public bodies may establish pools under certain circumstances.
66	294.825	Clarifies that the State Treasurer may adopt rules governing the Local Government Investment Pool.	
67	<i>No Section 67; subsequent sections not renumbered.</i>		
68	294.840	Housekeeping name changes.	Ability of the OIC to set rules applicable to investment pools.
69	294.845	Housekeeping name changes.	Holds Treasurer to various standards and duties with regard to the Local Government Investment Pool.
70	<i>No Section 70; subsequent sections not renumbered.</i>		
71	<i>No Section 71; subsequent sections not renumbered.</i>		
72	294.855	Deletes superfluous language.	Certification of bonds.
73	294.860	Deletes superfluous language regarding the holding of title instruments.	Relevant language moved to Section 22.
74	294.865	Housekeeping name changes.	Allows Treasurer or OIC to deduct amounts from the Oregon Short Term Fund to administer the program.
75	294.870	Housekeeping name changes and technical cleanup.	Clarifications regarding reporting and other requirements of Local Government Investment Pool.
76	294.875		
77	294.880		
78	294.882		
79	294.895	Housekeeping name changes.	Oregon Short Term Fund.
80	295.101	Housekeeping name changes.	Deposits of public funds.
81	311.701	Housekeeping name changes.	Senior Property Tax Deferral account.
82	327.425	Housekeeping name changes.	Common School Fund management.
83	348.703	Housekeeping name changes.	Oregon Growth Account.
84	351.695	Housekeeping name changes.	Higher Education Donation Fund.
85	391.520	Housekeeping name changes.	Mass Transportation Financing Authority.
86	391.605		
87	411.128	Housekeeping name changes.	Also standardizes language relative to a DHS account.
88	456.530	Conforming changes.	Conforms a cross reference re: Housing and Community Services Department.
89	696.030	Housekeeping name changes.	Rules regarding real estate transactions.

90		Conforming and name changes.	Conforms language in Iran divestiture law from 2012. (HB 4110)
91			
92			
93			
94			
95	128.316	Housekeeping name changes.	General definitions for trusts.
96	285A.306	Conforming changes.	Allows for OIC to make certain investment decisions instead of Treasurer with regards to various funds.
97	285A.654	Conforming changes.	
98	285B.119	Conforming changes.	
99	286A.025	Conforming changes.	
100	<i>No Section 100; subsequent sections not renumbered.</i>		
101	351.086	Conforming changes.	Allows for OIC to make certain investment decisions instead of Treasurer with regards to various funds.
102	367.015		
103	390.135		
104	391.800		
105	426.506		
106	456.535		
107	456.543		
108	468.215		
109	468A.490		
110	516.070		
111	541.942		
112	561.144		
113	757.738		
114		Provides that the new OIC is a continuation of the current OIC for purposes of existing contracts, etc. Portion of Treasury operating account attributable to new OIC functions will be transferred to the OIC.	The current OIC becomes the Board of the Corporation. Operating account already established in Section 9.
115		Provides that all references to "Oregon Investment Council" in law or rule may be considered as referring to "Oregon Investment Corporation."	
116		Repeals statutes made obsolete or redundant by this bill.	
		Repeals ORS 293.706.	Describes OIC; replaced by Section 3.
		Repeals ORS 293.713.	Other compensation of OIC members; covered by Section 53.
		Repeals ORS 293.716.	State Treasurer as OIC Investment Officer.
		Repeals ORS 293.721.	Investment objective; replaced by Section 4.
		Repeals ORS 293.731.	Investment policies; replaced by Section 4.
		Repeals ORS 293.736.	State Treasurer as OIC Investment Officer.
		Repeals ORS 293.741.	OIC contracts; replaced by Section 2.
		Repeals ORS 293.756.	Accounting rules; replaced by Section 2.
		Repeals ORS 293.761.	
		Repeals ORS 293.766.	Treasurer's communications with OIC.
		Repeals ORS 293.780.	Allows annuity contracts. Superfluous.
		Repeals ORS 293.822.	Findings and rules re: investment pools.
		Repeals ORS 293.824.	Covered by Sections 2 and 62-79.

	Repeals ORS 294.831.	
	Repeals ORS 294.847.	
	Repeals ORS 294.850.	
117	Establishes operative date allows for organization and transition activities to commence.	Corporation becomes operative on January 1, 2014. Enables OIC Board to hire an executive director prior to operative date. Allows for OIC and Treasury to take preparatory actions prior to effective date.
118	Provides that section captions are not statute or Legislative intent.	
119	Emergency clause.	Becomes effective upon passage.