Investment Advisory Council

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COMMITTEE

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LEGISLATIVE PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE

The Legislative Program Review and Investigations Committee is a joint, bipartisan, statutory committee of the Connecticut General Assembly. It was established in 1972 as the Legislative Program Review Committee to evaluate the efficiency and effectiveness of selected state programs and to recommend improvements where indicated. In 1975 the General Assembly expanded the Committee's function to include investigations and changed its name to the Legislative Program Review and Investigations Committee. During the 1977 session, the Committee's mandate was again expanded by the Executive Reorganization Act to include "Sunset" performance reviews of nearly 100 agencies, boards, and commissions, commencing on January 1, 1979.

The Committee is composed of twelve members, three each appointed by the Senate President Pro Tempore and Minority Leader, and the Speaker of the House and Minority Leader.

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INVESTMENT ADVISORY COUNCIL

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INVESTMENT ADVISORY COUNCIL

SUMMARY

The Investment Advisory Council was created in 1973 (P.A. 594) as a formal mechanism by which the state treasurer could call upon knowledgeable individuals for advice and assistance. The council is strictly advisory; the treasurer has sole responsibility for investment decisions concerning all public pension and other trust funds in his custody as well as all state funds not required for current disbursement.

The advisory council is comprised of: five members from the general public with experience in matters relating to investments; one representative of the teachers' retirement board; one representative of the state employees' retirement commission; and the secretary of the Office of Policy and Management and the state treasurer, both as ex officio members. All but the ex officio council members are appointed by the governor.

The Investment Advisory Council has undergone little statutory change over the years. However, legislative action during the 1982 session added five council members--three representing the teachers' unions and two representing the state employees' unions.

The council is located within the Office of the Treasurer for administrative purposes only. Staff support services required by the council are provided by the Treasury's Investment Department personnel. Members of the Investment Advisory Council are not compensated for their services but may be reimbursed for reasonable expenses. Total council expenses in FY 1980-81 were less than $1,200.

The major functions of the Investment Advisory Council are recommending investment policies to the treasurer and reviewing all state investment activities concerning approximately $1.8 billion in pension and other trust fund assets as well as investment of the state's "idle" cash. The council's advice and review activities are accomplished at monthly meetings. From January through December 1981, the council held 11 monthly meetings which generally lasted two hours.

Existence and Role of the Council

The Legislative Program Review and Investigations Committee found the Investment Advisory Council to be an efficient mechanism for regular review of the treasurer's investment decisions. In addition, the committee believed that the council's advice and review functions are needed to protect and promote the public interest, given the complex and critical decisions the treasurer makes regarding billions of dollars in trust funds and state civil list funds.

Although the program review committee considered strengthening the council's role, it found that regular review by impartial, knowledgeable individuals, combined with present statutory restrictions on state investment activities and the treasurer's personal liability for investment decisions, were sufficient safeguards against abuse of investment authority. *The Legislative Program Review and Investigations Committee, therefore, recommends that the Investment Advisory Council remain advisory and be continued without changes in its role.*

Council Membership

The Legislative Program Review and Investigations Committee recognizes the legitimacy of pension fund beneficiary representation in the treasurer's investment decision-making process. However, the committee also recognizes that the council has a fiduciary responsibility to provide advice and recommendations that are in the best interests of the state and all trust beneficiaries.

The program review committee believes that impartial experts are best able to evaluate the treasurer's investment decisions and recommend prudent investment policy. To insure the primary purpose of the council remains that of providing sound advice that is in the public interest, *the Legislative Program Review and Investigations Committee recommends amending the statutes to require the majority of Investment Advisory Council members to be public members, that is, individuals experienced in investment matters.*

Operating Procedures and Reporting Requirement

To improve the public's ability to scrutinize the treasurer's investment decisions and provide for a better accounting of the Investment Advisory Council's activities, *the Legislative Program Review and Investigations Committee recommends that the council:*

1) *take formal votes concerning recommended investment policies and record such votes in its minutes;*

2) *formalize its procedures concerning notice of meetings and executive sessions; and*

3) *submit its annual report to the General Assembly and to trust fund beneficiary groups as well as to the governor.*

General Revisions

The Legislative Program Review and Investigations Committee found that the statutes concerning the Investment Advisory Council have never been amended to conform with the general principles of the state's executive reorganization legislation (P.A. 77-614, Section 13) regarding terms, appointments and public members. In addition, the committee believes certain changes consistent with previous sunset review recommendations concerning attendance, meeting frequency and similar uniform provisions for all state entities should be adopted for the council. *The Legislative Program Review and Investigations Committee recommends that the Investment Advisory Council statutes be revised to reflect the provisions of the 1977 Executive Reorganization Act and to incorporate the following provisions:*

- *the council shall be required to meet at least quarterly;*
- *any member who fails to attend three consecutive meetings or to attend 50 percent of all meetings during any calendar year shall be deemed to have resigned; and*
- *no member shall serve more than two consecutive full terms.*

INTRODUCTION

Purpose and Authority

Chapter 28 of the Connecticut General Statutes provides for the periodic review of certain governmental entities and programs and for the termination or modification of those which do not significantly benefit the public health, safety, or welfare. This law was enacted in response to a legislative finding that a proliferation of governmental entities and programs had occurred without sufficient legislative oversight.

The authority for undertaking the initial review in this oversight process is vested in the Legislative Program Review and Investigations Committee. The committee is charged, under the provisions of Section 2c-3 of Chapter 28, with conducting a performance audit of each entity or program scheduled for termination. This audit must take into consideration, but is not limited to, the four criteria set forth in Section 2c-7. These criteria include: (1) whether termination of the entity or program would significantly endanger the public health, safety, or welfare; (2) whether the public could be adequately protected by another statute, entity, or program or by a less restrictive method of regulation; (3) whether the governmental entity or program produces any direct or indirect increase in the cost of goods or services and, if it does, whether the public benefits attributable to the entity or program outweigh the public burden of the increase in cost; and (4) whether the effective operation of the governmental entity or program is impeded by existing statutes, regulations or policies, including budgetary and personnel policies.

In addition to the criteria contained in Section 2c-7, the Legislative Program Review and Investigations Committee is required, when reviewing regulatory entities or programs, to consider, among other things: (1) the extent to which qualified applicants have been permitted to engage in any profession, occupation, trade, or activity regulated by the entity or program; (2) the extent to which the governmental entity involved has complied with federal and state affirmative action requirements; (3) the extent to which the governmental entity involved has recommended statutory changes which would benefit the public as opposed to the persons regulated; (4) the extent to which the governmental entity involved has encouraged public participation in the formulation of its regulations and policies; and (5) the manner in which the governmental entity involved has processed and resolved public complaints concerning persons subject to review.

Methodology

The Legislative Program Review and Investigations Committee's sunset review process is divided into three phases. The initial phase focuses on collecting quantitative and qualitative data related to each entity's background, purpose, powers, duties, costs and accomplishments. Several methods are used by committee members and staff to obtain this information. These include: (1) a review of statutes, transcripts of legislative hearings, entity records (e.g., minutes, complaint files, administrative reports, etc.), and data and statutes of other states; (2) staff observation of meetings held by each entity during the review period; (3) surveys of selected persons and groups associated with each entity; (4) formal and informal interviews of selected individuals serving on, staffing, affected by or knowledgeable about each entity; and (5) testimony received at public hearings.

During the second phase, the staff organizes the information into descriptive packages and presents it to the committee. The presentations take place in public sessions designed to prepare committee members for the hearings, identify options for exploration and alert entity officials to the issues the committee will pursue at the hearings.

The final step of the review involves committee members and staff following up on and clarifying issues raised at briefings and public hearings. During this period, the staff prepares decision papers and presents recommendations to the committee. The committee, in public sessions, then debates and votes upon recommendations for the continuation, termination or modification of each entity.

BACKGROUND

Legislative History

In Connecticut, the treasurer has been responsible for handling state fiscal matters since 1639. The current duties of the treasurer include paying against warrants, recording receipts, borrowing funds when required, and investing trust funds and surplus state monies. Among the trust funds in the custody of the treasurer are the state employees', teachers' and several other public employees' pension funds.

The Investment Advisory Council was created in 1973 (P.A. 594) in response to the recommendations of a task force of investment professionals that had been appointed by the treasurer to provide input concerning a reorganization of state investment operations. The council, comprised of five investment experts, a representative of the teachers' retirement board, a representative of the state employees' retirement commission with the state treasurer and the commissioner of finance and control as ex officio members, replaced the three-member Investment Committee.

The Investment Committee, composed of the finance and control commissioner and two gubernatorial appointees experienced in investment matters, was established in 1937. Its members were responsible for approving all investments made by the treasurer as well as providing investment advice. Prior to formation of the committee, the treasurer's investment decisions during the early years of this century were subject to the approval of either the Board of Finance and Control or the state banking commissioner.

Like the Investment Committee, the Investment Advisory Council was intended to be a formal mechanism by which the treasurer, an elected official not necessarily familiar with investment matters, could call upon knowledgeable individuals for advice and assistance. However, unlike its predecessor, the council's role is strictly advisory; sole and final responsibility for investment decisions rests with the treasurer. Another significant difference is that the membership of the Investment Advisory Council includes representatives of the two major retirement funds for which the treasurer is trustee.

Until recently, the Investment Advisory Council has undergone little statutory change. During the 1977 reorganization of the executive branch, the council was placed within the newly created Office of Policy and Management for administrative purposes only and the secretary of policy and management assumed the finance and control commissioner's role as an ex officio council member (P.A. 77-614). The council continued to operate within the treasurer's office despite its statutory assignment to the policy and management office. In 1980, Public Act 318 changed the council's official administrative affiliation to the Office of the Treasurer.

Two significant modifications, both concerning the membership of the Investment Advisory Council, occurred in 1982. Public Act 82-381 added two council members--one representing the teachers' unions and one representing the state employees' unions--effective July 1, 1982. However, the 1982 General Assembly also approved a collective bargaining contract that included an agreement calling for the addition of five pension plan participants to the Investment Advisory Council--three representing teachers' unions and two representing state employees' unions. This agreement, which supercedes P.A. 82-381, requires legislation incorporating the membership change to be submitted in the 1983 session. Thus, upon legislative approval, the statutes will provide for a 14-member Investment Advisory Council.

Other States

In a number of states the treasurer is responsible for investing surplus state funds, although sometimes this authority is placed with the state controller. However, unlike Connecticut, the boards that administer public employee pension funds in most other states also are responsible for investing the retirement fund assets. In making investment decisions, these retirement boards often are advised or sometimes supervised by an ad hoc or statutory group similar to Connecticut's Investment Advisory Council. The membership of investment advisory bodies in other states frequently includes investment professionals, but the majority of members tend to be pension plan participants; some advisory groups are comprised only of fund beneficiaries or their representatives.

In at least two states, Wisconsin and Minnesota, state investment boards have powers and duties similar to those of the Connecticut treasurer. The Wisconsin Investment Board is comprised of the secretary of the Department of Administration and six gubernatorial appointees--four of whom are experienced in investment matters and two of whom are nominated by the participants of the state employees' and teachers' retirement funds. The board is responsible for investing the state's "idle" cash as well as public employee pension funds.

In Minnesota, the members of the State Board of Investment, which has statutory authority over the administration and investment of all state funds including the state retirement system assets, are the five state constitutional officers: the governor, the attorney general, the state auditor, the treasurer and the secretary of state. A council, composed of 10 board-appointed public members experienced in investment matters along with the commissioner of finance and the executive directors of the participating retirement systems on an ex officio basis, advises the Minnesota investment board on policy matters and all proposed transactions. The advisory council also assists in preparing the board's investment reports.

In most states, pension and other trust funds are subject to an investment law, known as the "legal list", that specifies permitted investments or categories of investments. Legal lists vary in specificity from state to state; in a few states, bonds are the only legal instrument while other states, like Connecticut, authorize an extensive array of investment instruments. In addition, there are eight states, according to a recent National Conference of State Legislatures survey, that have a "prudent man" statute with no further limitations.[1]

The national conference's survey also found that 23 states were considering or had recently enacted legislation to broaden investment authority, primarily in the hope of increasing their return on assets. Connecticut's laws governing the treasurer's investment authority were revised to permit greater flexibility and a more diversified portfolio in the early 1970's as part of a major reorganization initiated by the treasurer. The reorganization of the state investment system was based on a 1971 report by the treasurer's Advisory Committee on Trust Fund Investments, the same group that recommended the establishment of the Investment Advisory Council. In addition to legal revisions, the ad hoc committee of nine prominent finance and investment experts suggested structural and staffing changes that are reflected in the current organization and practices of the Treasury's Investment Department.

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[1] The prudent man rule was formulated in the 1830 case <u>Harvard v. Amory</u> and with some clarifications remains the legal measure for the investment behavior of trustees. In essence, it requires a trustee to conduct himself faithfully, exercise sound discretion and invest with the care, skill, prudence and diligence that a prudent man acting in a like capacity would use. This case law standard has been incorporated as part of the investment laws of most states.

State Investment Activities

The Connecticut state treasurer has sole fiduciary responsibility for investment decisions concerning trust funds valued at approximately $1.8 billion in fiscal year 1980-81 as well as all state funds not required for current disbursement (civil list funds). The assets of each of the seven pension and the other trust funds in the treasurer's custody are shown in Table II-1. Two of the pension funds, the State Employees' Retirement Fund and the Teachers' Retirement Fund, account for almost 90 percent of all trust fund assets managed by the treasurer.

In regard to trust fund investments, the statutes provide the treasurer with broad authority. The treasurer, like all trustees in Connecticut, is required under C.G.S. Section 45-88 to invest with the care of a prudent investor. In addition, the treasurer is personally liable for any breach of his fiduciary duties. For the most part, limitations on day-to-day investment operations are contained in Treasury Department regulations and internal guidelines rather than in statute.

Table II-1. Trust Funds in the Custody of the State Treasurer: Assets as of June 30, 1981.

Retirement Funds	Assets ($ millions)	
Teachers'	$1,226.934	(66%)
State Employees'	413.133	(22%)
Municipal Employees' "A"	4.635	
Municipal Employees' "B"	132.036	(7%)
Probate Court	7.511	
General Assembly	.563	
States' Attorney	.129	
Other Trust Funds		
Soldiers', Sailors' and Marines'	40.314	(2%)
Second Injury	5.975	
Workers' Rehabilitation	4.024	
School Fund	2.920	
Federal Revenue Sharing	.467	
Commerce Department	.453	
Agricultural College	.129	
All Others	7.244	
TOTAL	$1,846.477	(100%)

Source: Annual Report of the Treasurer for the Fiscal Year July 1, 1980 to June 30, 1981.

Assets under the management of the treasurer are invested in five commingled investment funds: the Mutual Fixed Income Fund; the Mutual Equity Fund; the Short-Term Investment Fund; the Mutual Contract Fund; and the Mutual Mortgage Fund. The Mutual Fixed Income Fund invests in various fixed income instruments such as government and corporate bonds while the Mutual Equity Fund is a diversified portfolio of common stock.

According to the Investment Advisory Council's 1982 annual report, the Short-Term Investment Fund is designed to be "a safe, liquid haven for the temporary assets" of the various trust and civil list funds. This fund invests in instruments with relatively short maturities such as 90 day U.S. Treasury bills and 90 day certificates of deposit. In addition, the short-term fund invests in student loans guaranteed by the Connecticut Student Loan Foundation.

The Mutual Contract Fund, established in FY 1980-81, was set up to capture the attractive yields offered by major insurance companies on their investment contracts and to further diversify the pension funds portfolio. The Mutual Mortgage Fund has been a relatively small, inactive investment fund involving about 230 mortgages on individual dwellings. However, pursuant to P.A. 81-343, the treasurer recently established a new major mortgage investment fund--the Yankee Mac Fund. Yankee Mac, a pooled mortgage pass-through program, began operating in June 1981. The Treasury Department estimates that over the next five years about $450 million will be invested in Yankee Mac Mortgage Certificates.

An Investment Department, established in 1973 by the same act that created the Investment Advisory Council, provides the treasurer with staff support for state investment operations. The department, headed by a deputy treasurer for investments, is comprised of 14 full-time employees. The investment staff manage the Short-Term Investment Fund and about three-quarters of the Mutual Fixed Income Fund. The remainder of the state's fixed income investments are handled by external portfolio managers and the entire Mutual Equity Fund is managed by outside advisors. All expenses of the Investment Department are supported by major investment fund income.

In fiscal year 1980-81, personal services expenditures for the Treasury's Investment Department totaled $332,000 while overall costs were $2.4 million. This latter figure includes fees paid to the external advisors, other consultant fees and expenses related to investment transactions.

Structure

The Investment Advisory Council is located, for administrative purposes only, in the Office of the State Treasurer. At the time of the sunset review, the council was comprised of:

- five individuals from the general public who have experience in matters relating to investments;

- one representative of the teachers' retirement board who is a teacher as defined in C.G.S. Section 10-183b;

- one representative of the state employees' retirement commission who is a full-time state employee; and

- the Secretary of the Office of Policy and Management and the State Treasurer, both ex officio.

Two council members, one representing the state employees' unions and one representing the teachers' unions, were added to the council under P.A. 82-381, although this act was superceded by a collective bargaining agreement ratified by the General Assembly also in 1982. Under the agreement, legislation adding five union representatives, three from the teachers' unions and two from the state employees' unions, will be submitted for legislative approval during the 1983 session.

All but the two ex officio members of the council are appointed by the governor; the public members are appointed with the advice and consent of the Senate. The state employees' retirement commission and the teachers' retirement board submit lists of three nominees for their respective representatives to the treasurer who then recommends to the governor one nominee from each list for appointment to the council. The governor, however, is not restricted to the lists of nominees or the treasurer's recommendations in selecting appointees. The new union representative members of the council are to be appointed in a similar manner, with the teachers' unions and the state employees' unions submitting lists of nominees to the treasurer.

The terms of the council members are coterminous with the governor except that the five union members added under the 1982 collective bargaining agreement will serve two-year terms.

All members serve until their respective successors are appointed, and vacancies must be filled with appointees having the same qualifications.

The statutes prohibit any public member of the Investment Advisory Council or such member's business organization or affiliate from directly or indirectly contracting with or providing services to the state regarding the investment of public funds during his/her term or for one year thereafter. The teacher and state employee members, whether they represent a union or a pension administration agency, are restricted to participating in decisions concerning their respective retirement funds.

Although areas of expertise are not specified by law, the public members of the Investment Advisory Council have always included individuals with a wide variety of investment backgrounds and experience. During the sunset review period, two public members were vice presidents of investment divisions of Hartford insurance companies, one was responsible for the pension fund asset administration of a large public utility company, one was the president of a real estate development firm and a former real estate investment consultant, and another member, an economist, was the dean of a university school of business.

Purpose, Powers and Duties

The primary purpose of the Investment Advisory Council is to review state investments and recommend investment policies to the treasurer. To accomplish this purpose, the council is statutorily mandated to:

- review all investments made by the state treasurer;
- recommend policies consistent with pertinent laws including limits, conditions or restrictions on methods, practices or procedures for investment, reinvestment, purchase, sale or exchange transactions;
- examine the state's security investments at the close of each fiscal year and annually report their value to the governor; and
- give advice and consent to the treasurer regarding the appointment of the deputy treasurer for investments, investment officers and other investment department personnel.

The statutes further provide that the governor may direct the treasurer to change an investment when the council judges such action to be in the best interests of the state.

According to an analysis by the Connecticut Attorney General, the council's duties, although advisory, impose a fiduciary responsibility upon its members.[2] In a letter to the state treasurer dated September 18, 1981, the attorney general concluded:

> It is evident from the statutes creating the Investment Advisory Council that this State agency serves as an advisor, as its name indicates, to the State Treasurer on investment policies for State funds. Implicit in these advisory duties is the public trust with which the Council members are charged. Each member has a fiduciary responsibility to the public to provide the Treasurer as trustee of the public's funds, in good faith, with sound advice on investment policies to be applied to such funds. To this extent the Council members have a fiduciary relationship to the State of Connecticut and the public. As long as the Council has advised or recommended proper, lawful investment policies to the Treasurer, it has discharged its duties under the statutes.

Fiscal Information

The members of the Investment Advisory Council are not compensated for their services, but may be reimbursed for necessary expenses. According to the treasurer's office, no member has requested travel reimbursement during the past several years.

Other expenses directly attributable to the advisory council during fiscal year 1981-82 totaled less than $1,200, with meals accounting for about $900 and postage about $270. The staff of the treasurer's Investment Department provide support services, as needed, to the council. Estimates of staff time spent on functions related to the Investment Advisory Council were not available, but, according to the head of the investment department, only minimal personnel costs are involved.

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[2] A fiduciary, a person to whom property or power is entrusted for the benefit of another, has a legal responsibility to act in the best interests of the beneficiary(ies) and to manage the entrusted assets in a prudent manner.

ACTIVITIES

The Investment Advisory Council meets monthly to fulfill its charge to review all investments made by the treasurer. From January 1981 through May 1982, the council held 16 regular monthly meetings that generally lasted about two hours. At least five of the seven non ex officio members were present at most (12) meetings. The treasurer or deputy treasurer was present at all but two and the Secretary of the Office of Policy and Management or his designee attended five council meetings. In addition, the deputy treasurer for investments, the investment officers for the short-term, fixed income and equity investment funds, and various other Investment Department staff attended all 16 of the council meetings.

The council's two major activities--advising the treasurer on investment policies and reviewing Investment Department staff reports--are the focus of its regular monthly meetings. In accordance with a format adopted early in 1982, the members devote the first hour of each meeting to policy matters, and during the second hour, staff reports on the various investment funds are reviewed. Among the policy items discussed by the council in the first six months of 1982 were: the progress and recommendations of the Governor's Task Force on South African Investment Policy; the process and criteria for selecting external investment managers; the council's role in formulating the annual cash flow allocation plan; and the adequacy of the guidelines for Investment Department internal operations.

Subcommittees have been formed periodically to deal with more complex policy questions, such as whether the state should invest in equity real estate programs and how to further diversify the state's overall investment portfolio. In general, a subcommittee, usually comprised of three members, is responsible for researching a particular investment issue, sometimes with the assistance of Investment Department personnel or an outside consultant, and then presenting the information it develops to the full council. During the sunset review period, one subcommittee was assigned to "screen and scrutinize" alternative investment opportunities for portfolio diversification.

Prior to each monthly meeting, council members receive the Investment Department staff reports which contain detailed information on the transactions and performance of the short-term, fixed income and equity funds for the preceeding month. Reports on other investment funds that are not active on a monthly basis are prepared and sent to the members whenever there is activity. At the monthly meetings, the members review the staff reports, offering comments and feedback or posing questions to the treasurer and department staff. Once each fund has been discussed to the satisfaction of all members, a motion is made to formally accept the staff report.

Another important but less frequent activity of the Investment Advisory Council is the annual review of all outside investment advisors. Each year, the advisors meet with the council to present reports and explanations on their overall investment approach including styles, diversification, goals and strategies. Six annual advisor reviews, each lasting about 45 minutes, were conducted by the council in 1981. In addition, council members interview prospective advisors and have held special meetings with external managers whose performance they have judged as unsatisfactory.

Applicants for key investment department positions are also interviewed by the Investment Advisory Council. Although authorized to give consent regarding all investment staff, the council, due to time constraints, has limited its involvement to approving the final selection of only the deputy treasurer for investments and the officers for the major commingled investment funds.

As required by statute, the council submits an annual report to the governor. This report, which has always been done in the form of a letter from the council chairman, states the net asset value of all trusts under management by the treasurer and briefly summarizes the performance of each of the five commingled investment funds. Copies of the council's most recent annual report (1982) were also forwarded to the Legislative Auditors of Public Accounts.

Typical Meeting

The Investment Advisory Council meetings follow a written agenda but tend to be conducted somewhat informally. Policies and procedures are openly discussed with the treasurer and staff and most advice is offered as a suggestion or opinion rather than a formal recommendation. An analysis of the council minutes from 1973 through June 1982 showed that in the first few years of its existence, the council often recorded its investment advice or its support for the treasurer's decisions through a formal vote. Official motions or votes on matters discussed now appear less frequently in the minutes. As the current council chairman explained in his public hearing testimony to the Legislative Program Review and Investigations Committee:

> ...we don't normally as a matter of formality take a vote on all issues that come through. We do approve all of the [investment fund] transactions and take a formal vote on that, that's an after the fact vote of the transactions that occur during the preceeding month. But in terms of other policies we have just a good discussion on that and good debate and then we proceed from there. But we have not had a vote on many of those matters. We did on Yankee Mac and we will continue to do so in the future on that because of its particular importance.[3]

At the meetings observed by the committee staff during the first half of 1982, the treasurer seemed to initiate most discussion and to solicit the council's advice. However, at the council's request, several special sessions were held to permit the members greater involvement in the treasurer's cash flow allocation planning process. The annual cash flow allocation plan establishes how trust fund assets will be distributed among various investment instruments over the next one to five years. At the special sessions, members provided feedback on the treasurer's proposals for asset allocation and actively participated in this critical investment planning process.

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[3] Dean Patenaude, chairman, Investment Advisory Council, LPR&IC public hearing on Sunset 1983, June 10, 1982, p. 12.

ANALYSIS AND RECOMMENDATIONS

The Legislative Program Review and Investigations Committee sunset review of the Investment Advisory Council focused on the existence and role of the council, council membership, operating procedures including the council reporting requirement and the revision of statutory provisions to comply with uniform standards.

Existence and Role of the Council

In determining whether there was a public need for the continued existence of the Investment Advisory Council, the Legislative Program Review and Investigations Committee considered the benefits the council provides as: 1) a source of professional investment advice for the treasurer, an elected official not necessarily familiar with investment matters; and 2) a mechanism for monitoring the treasurer's investment activities to ensure they are in the state's best interests. Given the complex and critical nature of the investment decisions the treasurer makes in regard to billions of trust and civil list fund dollars, there is no question that the council's advice and review functions are needed to protect and promote the interests of fund beneficiaries and the general public.

By meeting once a month, the council members have the opportunity to thoroughly examine all transactions and determine whether the treasurer has complied with statutes, regulations and internal guidelines governing investment practices. The program review committee found that the members can and do question monthly staff reports and provide feedback on investment policies and performance. The committee's review of council minutes from 1973 through June 1982 showed that the council has offered investment advice at nearly every meeting and that the treasurer frequently has solicited input from council members.

Interviews with present and former council members conducted as part of the committee review revealed that there was some dissatisfaction over the role the council played in determining rates for the first (June 1981) series of the Yankee Mac mortgage program. However, the members were able to resolve this matter informally through discussions with the treasurer. As a result, the Investment Advisory Council was more actively involved in the development of subsequent programs and worked closely with the treasurer in establishing the rate for the May 1982 Yankee Mac offering.

The council also has played an active role in two of the treasurer's most critical investment functions: the selection of outside investment managers/advisors and the development of the annual cash flow allocation plan. Furthermore, as the treasurer noted in his public hearing testimony to the Legislative Program Review and Investigations Committee:

> ...the Investment Advisory Council provides a vehicle for talented individuals to offer their best advice and recommendations on investment matters voluntarily to the State of Connecticut for virtually no cost to the state. And, I must add, such advice from such a distinguished group would cost thousands and thousands of dollars on the open market.[4]

In terms of performance, it appears that the current state investment system in which the council advises and reviews the treasurer's decisions has produced satisfactory results. An analysis by A.G. Becker, the principal performance management evaluation consulting firm in the country, revealed that the annualized rate of return of 6.2 percent for Connecticut's retirement funds for the period 1974 through 1981 was better than approximately 80 percent of the firm's 37 other state retirement fund clients. As the data in Figure IV-1 show, an annualized return of 7.5 percent was achieved by only 5 percent of the A.G. Becker clients while the median fund return was 4.9 percent.

Connecticut's retirement fund investment performance also compares well with two widely accepted investment performance measures. While Connecticut's 6.2 percent annualized return was less than the Standard and Poor's 500 Stock Market return of 7.9 percent (annualized for the same period, 1974-1981), the difference is due primarily to the fact that the state's investments were not all stocks, like Standard and Poor's. Similarly, since Connecticut retirement funds are not solely invested in bonds, the state's annualized return was considerably higher than the 4.0 percent annualized return for 1974-1981 of the Kuhn Loeb Bond Market Index.

In general, comparisons such as those presented above must be viewed cautiously since the type of investments made is only

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[4] Henry E. Parker, Treasurer, State of Connecticut, LPR&IC public hearing on Sunset 1983, June 10, 1982, p. 22.

Figure IV-1. Selected State Retirement Fund Returns for the Period 1974-1981.

	Annualized Return
State of Connecticut Retirement Funds	6.2%
All A.G. Becker State Retirement Fund Clients[1]	
5th Percentile	7.5%
25th Percentile	5.2%
Median Fund	4.9%
75th Percentile	4.4%
95th Percentile	4.0%
S & P 500 Stock Market Return	7.9%
Kuhn Loeb Bond Market Index	4.0%

[1] In 1982, the A.G. Becker firm was evaluating the performance of 38 state retirement funds, including Connecticut's, with an aggregate market value of $81 billion.

Source: Connecticut Office of the Treasurer, Investment Department.

one of many factors that determine performance. However, treasury officials and members of the council attribute the generally good performance by Connecticut's retirement fund investments relative to that of other state investors, in part, to the current decision-making and review structure as well as liberal investment laws and modern investment practices.

Overall, the program review committee found the Investment Advisory Council to be an efficient and effective mechanism for regular independent review of the treasurer's investment decisions by impartial, knowledgeable individuals. *The Legislative Program Review and Investigations Committee, therefore, recommends that the Investment Advisory Council be continued and that its role remain advisory.*

The committee did consider strengthening the role of the Investment Advisory Council by providing it with the power to approve all investment decisions but determined that such authority was unnecessary. Although the council cannot force the treasurer to change an investment decision, members have the ability through the monthly review process to promote modifications and suggest improvements. While the situation has never arisen, the council also can request the governor to direct the treasurer to change any investment if the members feel such an action would be in the best interests of the state.

The committee believes that present statutory restrictions on investment matters and the treasurer's personal liability for investment decisions are sufficient safeguards against the abuse of investment authority. These checks, combined with regular review by an independent council whose members have a fiduciary responsibility to the public, adequately protect the state's and the trust fund beneficiaries' interest in investment matters.

Council Membership

With its present membership, the Investment Advisory Council, like many parallel groups in other states, is a mechanism for receiving input from pension fund participants as well as advice from investment professionals. Recent contract negotiations and legislative actions have provided for greater representation of retirement fund participant groups on the council. Under these changes, seven members will be representing pension plan participant interests (the two existing employee retirement board nominees plus the five new union representatives) while the five current investment experts and the two ex officio members will have fiduciary responsibility solely to the public.

The Legislative Program Review and Investigations Committee recognizes the legitimacy of trust fund beneficiary representation in the treasurer's investment decision-making process. However, the council's primary duties, in the committee's opinion, are to review all investments and recommend investment policies that are proper, legal and in the best interests of the state. In addition, the Investment Advisory Council presently has a fiduciary responsibility to the public and the state to provide advice and recommendations that are in the best interests of the state and all beneficiaries, not any particular beneficiary group.

To insure the primary role of the council remains that of providing investment advice that is in the best interests of the state, the majority of council members should be impartial experts whose fiduciary responsibility clearly is to the public. *Therefore, the Legislative Program Review and Investigations Committee recommends amending the statutes concerning the Investment Advisory Council to require that individuals experienced in investment matters--public members--comprise the majority of council membership.*

Operating Procedures and Reporting Requirement

The Legislative Program Review and Investigations Committee examined the activities of the Investment Advisory Council and found its operations satisfactory. In general, meetings are well-run and the council performs its advice and review functions in a businesslike manner, fully complying with all relevant statutes and regulations. However, the committee did identify several areas where modifications would improve the public's ability to scrutinize the treasurer's investment decisions and provide for a better accounting of the council's activities.

The Legislative Program Review and Investigations Committee recommends that the Investment Advisory Council take formal votes concerning recommended investment policies and record such votes in its minutes. At present, it is difficult to determine from a review of council minutes the extent to which members have reviewed the treasurer's investment decisions and which policies have been recommended or supported by the council. Since the council minutes are the only public record of the process for deciding state trust fund investment policies and practices, they should provide a full accounting of the meetings, including the council members' opinions and discussions.

The Legislative Program Review and Investigations Committee also recommends that council procedures concerning notice of meetings and executive sessions be formalized. At one council meeting observed by the program review committee staff, the first ever to be attended by a member of the press, questions were raised about the council's ability to enter into executive session and the proper procedure for going into such a session. The committee believes this and related public information issues should be resolved to avoid potential noncompliance with provisions of the Freedom of Information Act.

The committee further believes that intent of the state's public disclosure law would be served if the Investment Advisory Council's annual report were more widely distributed. *Therefore, the Legislative Program Review and Investigations Committee recommends that the council submit its annual report on the value of the state's trust fund investments to the General Assembly and to the trust fund beneficiary groups as well as to the governor.*

General Revisions

In its review of the Investment Advisory Council, the Legislative Program Review and Investigations Committee discovered that certain statutes concerning the Investment Advisory Council do not conform to the general principles of the state's goverment reorganization legislation. Although there is compliance currently with the reorganization principles regarding terms, appointments and public members that are intended to apply to all executive branch agencies, technical revisions are needed to clarify statutory intent.

To further promote uniformity and consistency among all state entities, the committee believes that provisions concerning frequency of meetings, attendance and similar matters recommended in previous sunset reports and contained in P.A. 80-484 should be adopted for the Investment Advisory Council. *Therefore, the Legislative Program Review and Investigations Committee recommends that the statutes concerning the Investment Advisory Council be revised to reflect the provisions of the 1977 Executive Reorganization Act and to incorporate the following provisions:*

- *the council shall be required to meet at least quarterly;*
- *any member who fails to attend three consecutive meetings or to attend 50 percent of all meetings during any calendar year shall be deemed to have resigned; and*
- *no member shall serve more than two consecutive full terms.*

APPENDICES

APPENDIX A

Summary Sheet

INVESTMENT ADVISORY COUNCIL

STATUTORY REF: C.G.S. Chapter 32

ESTABLISHED: 1973 (P.A. 594)

ORGANIZATIONAL LOCATION: State Treasurer's Office, administrative purposes only

PURPOSE: To review state investments and recommend investment policies.

POWERS AND DUTIES:

- Review all investments made by the state treasurer
- Recommend policies consistent with pertinent laws including limits, conditions or restrictions on methods, practices or procedures for investment, reinvestment, purchase, sale or exchange transactions
- Examine the state's security investments at the close of each fiscal year, and report the value to the governor (the treasurer's annual report must include the estimated value of all security investments owned by the state)
- Give advise and consent regarding the treasurer's appointment of the deputy treasurer for investments, investment officers and other investment department personnel

COMPOSITION: Nine members--five from general public with experience in matters relating to investments; one representative of the teacher's retirement board who is a teacher as defined in C.G.S. Sec. 10-183b; one representative of the state employees' retirement commission who is a full-time state employee; and, on an ex officio basis, the secretary of the office of policy and management and the state treasurer

APPOINTING AUTHORITY: Governor; teachers' retirement board and state employees' retirement commission representatives may be appointed from three nominees submitted to the treasurer by their respective organizations

TERMS: Coterminous with governor

RESTRICTIONS ON MEMBERSHIP:

No "public" member or such member's business organization or affiliate shall directly or indirectly contract with or provide any services for state investments during member's service on the council or one year thereafter

BUDGET: None; members are not compensated beyond reasonable expenses. Staff from the Treasury's Investment Department provide support services as needed

MAJOR LAWS GOVERNING INVESTMENTS:

- Treasurer to invest trust funds with the care of a prudent investor ("prudent man rule") (C.G.S. Sec. 45-88)
- Not more than 50 percent of the book value of each trust fund to be invested in common stocks (3-13d)
- Treasurer may consider social, economic and environmental implications of trust fund investments and shall consider foreign policy and national interests factors (3-13d)
- No state funds to be invested in corporations engaged in business with Iran which is contrary to U.S. national interests (3-13g)
- Unless certain minimum requirements have been satisfied, no state funds to be invested in corporations doing business in South Africa, and all monies invested in such corporations shall be disinvested (P.A. 82-324)

APPENDIX B

Legislative Changes Needed to Implement the Legislative Program Review and Investigations Committee's Recommendations

- Amend Section 3-13b of the Connecticut General Statutes to require that individuals experienced in investment matters (public members) comprise the majority of Investment Advisory Council members.

- Amend Section 3-13b(c) of the Connecticut General Statutes to require that the Investment Advisory Council's annual report be submitted to the General Assembly and to trust fund beneficiary groups as well as the governor.

- Amend Section 3-13b of the Connecticut General Statutes to bring the Investment Advisory Council provisions concerning public members, and terms, into conformance with general principles of the Executive Reorganization Act (P.A. 77-614, Section 13).

- Amend Section 3-13b of the Connecticut General Statutes to incorporate the provisions concerning meeting frequency, attendance and terms for the Investment Advisory Council as recommended by the Legislative Program Review and Investigations Committee.