

HOUSE BILL REPORT

HB 2346

As Reported by House Committee On:
Trade & Economic Development

Title: An act relating to investing in Washington businesses.

Brief Description: Promoting investment in Washington businesses.

Sponsors: Representatives Veloria, O'Brien, Kenney, Upthegrove, Santos, Murray, Sullivan, Simpson, G., Morrell, Hudgins and Schual-Berke.

Brief History:

Committee Activity:

Trade & Economic Development: 1/23/04, 2/5/04 [DPS].

Brief Summary of Substitute Bill

- Requires the Washington State Investment Board (SIB), in making and implementing private equity investment decisions, look first at Washington investment opportunities for diversification, unless it is not prudent under the circumstances to do so.

HOUSE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 7 members: Representatives Veloria, Chair; Skinner, Ranking Minority Member; Blake, Chase, McCoy, Ormsby and Pettigrew.

Minority Report: Do not pass. Signed by 5 members: Representatives McDonald, Assistant Ranking Minority Member; Condotta, Kristiansen, Priest and Rodne.

Staff: Tracey Taylor (786-7196).

Background:

The Washington State Investment Board (SIB) is the state agency charged with investing and managing \$52.8 billion of assets in 33 separate funds. The types of funds include retirement, industrial insurance, deferred compensation, permanent funds and other trust funds.

As of June 30, 2003, the SIB had \$1.7 billion invested in Washington state assets. This includes \$61.4 million in private equity investments in 69 Washington-based companies.

The SIB is governed by a 15 member board that includes 10 voting and five non-voting members. Members of the SIB are fiduciaries who are charged with managing the investments for the retirement and public trust funds with the highest standard of professional conduct for the "exclusive benefit of the fund beneficiaries."

The SIB must invest and manage the assets with "reasonable care, skill, prudence, and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose." *RCW 43.33A.140*. Investments are not to be considered in isolation, "but in the context of the investment of the particular fund as a whole and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited for that fund." *RCW 43.33A.140(1)*. A particular fund's investment are to be diversified, unless special circumstances exist and the SIB "reasonably determines that the purposes of that fund are better served without diversifying." *RCW 43.33A.140(2)*. "However, no corporate fixed income issue or common stock holding may exceed 3 percent of the cost or 6 percent of the market value of the assets of that fund." *RCW 43.33A.140(2)*.

In March 2003, the SIB adopted a new policy for economically targeted investments (ETI) in Washington. An ETI is an investment having the primary objective of investment return to pension trust fund assets and the collateral objective of assisting the regional economy and the economic well-being of the State of Washington, its localities and its residents.

- The SIB will only consider investing in those ETIs that are commensurate on a risk-adjusted financial basis to alternatively available investments.
- The decision to invest in an ETI for its collateral benefits shall only be made after the opportunity is deemed acceptable based exclusively on its economic investment merits.
- The collateral benefits of an ETI shall not be considered part of the return on the investment nor part of the risk reduction.
- ETIs shall be made in accordance with the SIB's approved asset allocation policies and included within existing asset categories as well as conform to all the laws, policies and procedures governing the SIB.
- ETIs shall receive the proper level of due diligence and evaluation consistent with all other investment opportunities evaluated of similar type of classification. *WSIB Policy 2.05.600 (2003)*.

The SIB will only consider the secondary objective of promoting economic growth and well-being in Washington when it is not in conflict with its other statutory duties: to maximize return at a prudent level of risk, affording the funds beneficiaries loyalty, care,

skill, prudence, diligence and diversification. *WSIB Policy 2.05.600 (2003)*.

The SIB has requested its private equity general partners to provide annually a listing of all Washington-based investments evaluated during each calendar year. This list will include a description of the opportunity as well as the ultimate investment decision. A summary of the SIB's activities regarding ETIs will be submitted to the SIB, its beneficiaries, the Legislature and the Governor on an annual basis. *WSIB Policy 2.05.600 (2003)*.

Summary of Substitute Bill:

In making private equity decisions, the SIB has a duty to look at Washington opportunities for diversification unless it is not prudent to do so under the circumstances. This includes direct investment into companies or placing money with Washington private equity firms for investment by the firms into Washington start-up and emerging businesses.

Private equity is equity financing that is provided for starting up, expanding or relocating a company or related purposes such as seed capital, research and development, and the introduction of a product or process into the marketplace.

A Washington private equity firm is an equity firm that has a majority of its employees in this state or has at least one managing partner domiciled in this state that has made significant capital investment and that provides equity financing for starting up or expanding a company.

Substitute Bill Compared to Original Bill:

The substitute eliminates Section 3 of the original bill. That section required the SIB to meet certain diversification requirements for all its trust funds. The SIB is prohibited in the original bill from investing more than 25 percent of its funds in a single industry, more than 5 percent in any one company, or own more than 10 percent of the equity in any one business.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on February 5, 2004.

Effective Date of Substitute Bill: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This legislation helps ensure that the state attracts and retains

promising, emerging businesses. It also encourages investment in a way that strengthens the state economy. In addition, there is a lack of diversification by the SIB, especially in its private equity investments.

Testimony Against: The SIB is interested in helping the state's economy and has begun to do so with its fairly new ETI program. The bill's purpose is noble, but the funds are held in trust for the plan's beneficiaries. The SIB has a fiduciary duty to these beneficiaries that cannot be disregarded. In addition, the SIB itself does not make the individual decisions on where to invest private equity dollars, its general partners do so. The SIB has been successful due to its adherence to the prudent investment standard.

Persons Testifying: (In support) Representative Veloria, prime sponsor; Glenn Gregory, Tabor 100; and Bev Hermanson, Washington Federation of State Employees.

(With concerns) Joe Dear, Washington State Investment Board.

Persons Signed In To Testify But Not Testifying: None.