MUTUAL FUND INVESTMENTS BY PUBLIC RETIREMENT SYSTEMS
(HB 217; Representative Maxwell)

Issue: Amend the Public Retirement System Investment Authority Law found at Article 7 of Chapter 20 of Title 47 of the Official Code of Georgia Annotated, by specifically authorizing public retirement systems to invest in open end mutual funds, commingled funds and collective investment funds.

Need for Clarifying Legislation: On July 14, 2014, an attorney with the Georgia Department of Law issued a letter to the Georgia Department of Audits and Accounts in response to an inquiry from the Department inquiring whether Georgia law allows public retirement systems to invest in mutual funds. The letter advised that "it appears that public retirement systems may not invest in mutual funds under Georgia law." The letter has raised many concerns for public retirement systems in Georgia. In addition, most investment professionals and legal practitioners in Georgia do not agree with the overall conclusions expressed in the letter.

In response to these concerns, the Department of Audits and Accounts issued a statement in an email to public retirement systems dated September 11, 2014 acknowledging that many local governments have been investing in mutual funds even though the Public Retirement Systems Investment Authority Act does not explicitly authorize such investments. The Department further noted that it was in the process of researching the legal authority of such investments, and until definitive guidance was provided, the Department "will not take any action against local governments whose investment portfolios currently include mutual funds."

Even though the term "mutual fund" does not explicitly appear in the retirement systems investment authority law, public retirement systems in Georgia have long interpreted the existing language in O.C.G.A. §47-1-12 and O.C.G.A. §47-20-83(a), among other sections applicable to large retirement systems, to permit mutual fund investments. In fact, according to the Report of the State Auditor on Local Retirement Plans issued January 1, 2013,[1] 46 out of 66 (approximately 70%) local retirement plans invest in "Mutual Funds or Similar Asset Pools."[2] However, given the Georgia Department of Law's July 14, 2014 guidance to the Department of Audits and Accounts questioning those investments, the need for clarifying legislation specifically authorizing investments in mutual funds and collective and commingled funds has become imperative.

Importance of Mutual Funds: Nationally, mutual funds are one of the most common investment vehicles for both individual and institutional investors. As of 2013, and in accordance with the 2014 Investment Company Factbook, the mutual fund industry controlled over $15 trillion in assets, had 7,707 registered funds, dispersed through 264,848,000 individual and omnibus accounts. Providing access to this widely accepted investment product is critical to the investment success for the many public retirement systems throughout Georgia.

Mutual Fund Background: Per Section 3(a)(1) of the Investment Company Act of 1940, the primary law that governs investment companies, investment companies are classified one of three types; management companies, unit investment trusts, or closed-end. Management companies are divided into open-end companies ("mutual funds") and closed-end companies. Mutual funds are management investment companies that offer or have outstanding redeemable securities of which they are the issuers. Mutual funds hold a portfolio of securities, typically managed by an investment adviser. Mutual funds generally offer an unlimited number of their shares to the public on a continuous basis. If an investment

[1] The report can be found at https://www.audits.ga.gov/NALGAD/Files/Report_of_State_Auditor_-_Local_Retirement_Plans_Jan_1x_2013.pdf.
[2] *See* Report of the State Auditor, Local Retirement Plans, January 1, 2013, Appendix B.

company is organized or otherwise created under the laws of the United States or of a State, meets the definition of an investment company, and cannot rely on an exception or an exemption from registration, generally it must register with the Securities and Exchange Commission ("SEC") under the Investment Company Act and must register its public offerings under the Securities Act of 1933.

Collective and Commingled Funds are similar in construction and composition, but rather than being registered with the SEC, they fall under the supervision of the Comptroller of the Currency. In many instances larger investment amounts may receive lower fees using these vehicles versus other mutual funds.

Reasons to Amend the Public Retirement System Investment Authority Law to specifically include Mutual Funds and Commingled Funds:

1. Mutual funds and commingled funds have enormous breadth of use and acceptance among individual and institutional investors;

2. Mutual funds and commingled funds provide significant diversification, efficiency of use, competitive cost structure and exposure to asset classes not readily accessible through traditional separately managed investment accounts;

3. Mutual funds trade on the National Securities Clearing Corp (NSCC) Platform that provides for daily trades and liquidity;

4. Georgia defined contribution plans utilize mutual funds, or collective funds or similar commingled funds extensively as their investment vehicles for plan participants. It would be inconsistent with prudent action to forbid these types of investment options for defined benefit public retirement systems in Georgia while authorized for Georgia defined contribution plans;

5. Per the SEC, all existing money market funds are classified as mutual funds. If mutual funds are not permitted under the Georgia Code, all public retirement systems would have to terminate use of money market accounts;

6. The State of Georgia has an S&P 500 Index fund which is a commingled pool and considered a type of mutual fund. In addition, they offer other commingled type investments;

7. Many public retirement systems in Georgia already invest in mutual funds and collective and commingled funds in order to access highly qualified investment managers, access to certain markets, save on investment costs, and reduce certain risk exposure. According to the State Auditor, approximately 70% of local retirement plans already invest in mutual funds or similar asset pools.

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