

JAN 22 2008

A BILL FOR AN ACT

RELATING TO INNOVATION CAPITAL.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The legislature finds that Hawaii's desire for
2 economic growth that benefits all residents depends on building
3 our State's human resources, and in turn, applying these highly
4 skilled resources to the creation and adoption of innovation
5 across its economy.

6 The legislature further finds that economic growth and
7 diversification throughout many communities has been enhanced by
8 the availability of venture capital funding for entrepreneurs
9 engaged in building innovative new ventures. Well-known regions
10 such as Silicon Valley, Route 128 in Boston, Austin, Texas, and
11 the Research Triangle in North Carolina have benefited greatly
12 from the combination of scientific research, an entrepreneurial
13 culture driving high technology growth, and funding availability
14 for early stage equity investments. Other areas similar in size
15 and population to Hawaii, including San Diego, Salt Lake City,
16 Seattle, and Boulder have also developed strong technology-based
17 businesses with the assistance of venture capital.

1 The source of this venture capital is derived in large part
2 through employee pension funds. Of the approximately
3 \$27,000,000,000 of venture investment taking place in 2007, over
4 half was provided by pension funds. Many public pension funds
5 target investments in-state to provide enhanced returns to the
6 pensioners and support the development of high-growth businesses
7 within local communities.

8 The employees' retirement system of the State of Hawaii has
9 committed approximately \$550,000,000 to the alternative asset
10 category including venture capital, but none of it is invested
11 in Hawaii. The legislature finds that this lack of investment
12 in Hawaii venture capital by the employees' retirement system
13 may be due to a lack of large-scale qualified investment
14 opportunities and concerns over the possible breach of fiduciary
15 duty and prudent investor rules related to early stage
16 investing. Some jurisdictions such as Arkansas and Michigan
17 encourage local investment by pension funds by relieving
18 fiduciaries of liability for investing in local venture
19 capital. Others, such as the State of Oregon, have legislated
20 investment by the public pension fund in local venture capital
21 where prudent.

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1 The purpose of this Act is to encourage the employees'
2 retirement system to invest in Hawaii venture capital.

3 SECTION 2. Section 88-119, Hawaii Revised Statutes, is
4 amended to read as follows:

5 "**§88-119 Investments.** Investments may be made in:

6 (1) Real estate loans and mortgages. Obligations (as
7 defined in section 431:6-101) of any of the following
8 classes:

9 (A) Obligations secured by mortgages of nonprofit
10 corporations desiring to build multirental units
11 (ten units or more) subject to control of the
12 government for occupancy by families displaced as
13 a result of government action;

14 (B) Obligations secured by mortgages insured by the
15 Federal Housing Administration;

16 (C) Obligations for the repayment of home loans made
17 under the Servicemen's Readjustment Act of 1944
18 or under Title II of the National Housing Act;

19 (D) Other obligations secured by first mortgages on
20 unencumbered improved real estate owned in fee
21 simple; provided that the amount of the
22 obligation at the time investment is made therein

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1 shall not exceed eighty per cent of the value of
2 the real estate and improvements mortgaged to
3 secure it, and except that the amount of the
4 obligation at the time investment is made therein
5 may exceed eighty per cent but no more than
6 ninety per cent of the value of the real estate
7 and improvements mortgaged to secure it; provided
8 further that the obligation is insured or
9 guaranteed against default or loss under a
10 mortgage insurance policy issued by a casualty
11 insurance company licensed to do business in the
12 State. The coverage provided by the insurer
13 shall be sufficient to reduce the system's
14 exposure to not more than eighty per cent of the
15 value of the real estate and improvements
16 mortgaged to secure it. The insurance coverage
17 shall remain in force until the principal amount
18 of the obligation is reduced to eighty per cent
19 of the market value of the real estate and
20 improvements mortgaged to secure it, at which
21 time the coverage shall be subject to
22 cancellation solely at the option of the board.

1 Real estate shall not be deemed to be encumbered
2 within the meaning of this subparagraph by reason
3 of the existence of any of the restrictions,
4 charges, or claims described in section
5 431:6-308;

6 (E) Other obligations secured by first mortgages of
7 leasehold interests in improved real estate;
8 provided that:

9 (i) Each leasehold interest at the time shall
10 have a current term extending at least two
11 years beyond the stated maturity of the
12 obligation it secures; and

13 (ii) The amount of the obligation at the time
14 investment is made therein shall not exceed
15 eighty per cent of the value of the
16 respective leasehold interest and
17 improvements, and except that the amount of
18 the obligation at the time investment is
19 made therein may exceed eighty per cent but
20 no more than ninety per cent of the value of
21 the leasehold interest and improvements
22 mortgaged to secure it;

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1 provided further that the obligation is insured
2 or guaranteed against default or loss under a
3 mortgage insurance policy issued by a casualty
4 insurance company licensed to do business in the
5 State. The coverage provided by the insurer
6 shall be sufficient to reduce the system's
7 exposure to not more than eighty per cent of the
8 value of the leasehold interest and improvements
9 mortgaged to secure it. The insurance coverage
10 shall remain in force until the principal amount
11 of the obligation is reduced to eighty per cent
12 of the market value of the leasehold interest and
13 improvements mortgaged to secure it, at which
14 time the coverage shall be subject to
15 cancellation solely at the option of the board;

16 (F) Obligations for the repayment of home loans
17 guaranteed by the department of Hawaiian home
18 lands pursuant to section 214(b) of the Hawaiian
19 Homes Commission Act, 1920; and

20 (G) Obligations secured by second mortgages on
21 improved real estate for which the mortgagor
22 procures a second mortgage on the improved real

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1 estate for the purpose of acquiring the
2 leaseholder's fee simple interest in the improved
3 real estate; provided that any prior mortgage
4 shall not contain provisions that might
5 jeopardize the security position of the
6 retirement system or the borrower's ability to
7 repay the mortgage loan.

8 The board may retain the real estate, including
9 leasehold interests therein, as it may acquire by
10 foreclosure of mortgages or in enforcement of
11 security, or as may be conveyed to it in satisfaction
12 of debts previously contracted; provided that all the
13 real estate, other than leasehold interests, shall be
14 sold within five years after acquiring the same,
15 subject to extension by the governor for additional
16 periods not exceeding five years each, and that all
17 the leasehold interests shall be sold within one year
18 after acquiring the same, subject to extension by the
19 governor for additional periods not exceeding one year
20 each;

21 (2) Government obligations, etc. Obligations of any of
22 the following classes:

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- 1 (A) Obligations issued or guaranteed as to principal
2 and interest by the United States or by any state
3 thereof or by any municipal or political
4 subdivision or school district of any of the
5 foregoing; provided that principal of and
6 interest on the obligations are payable in
7 currency of the United States; or sovereign debt
8 instruments issued by agencies of, or guaranteed
9 by foreign governments;
- 10 (B) Revenue bonds, whether or not permitted by any
11 other provision hereof, of the State or any
12 municipal or political subdivision thereof,
13 including the board of water supply of the city
14 and county of Honolulu, and street or improvement
15 district bonds of any district or project in the
16 State; and
- 17 (C) Obligations issued or guaranteed by any federal
18 home loan bank including consolidated federal
19 home loan bank obligations, the Home Owner's Loan
20 Corporation, the Federal National Mortgage
21 Association, or the Small Business
22 Administration;

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- 1 (3) Corporate obligations. Below investment grade or
2 nonrated debt instruments, foreign or domestic, in
3 accordance with investment guidelines adopted by the
4 board;
- 5 (4) Preferred and common stocks. Shares of preferred or
6 common stock of any corporation created or existing
7 under the laws of the United States or of any state or
8 district thereof or of any country;
- 9 (5) Obligations eligible by law for purchase in the open
10 market by federal reserve banks;
- 11 (6) Obligations issued or guaranteed by the International
12 Bank for Reconstruction and Development, the
13 Inter-American Development Bank, the Asian Development
14 Bank, or the African Development Bank;
- 15 (7) Obligations secured by collateral consisting of any of
16 the securities or stock listed above and worth at the
17 time the investment is made at least fifteen per cent
18 more than the amount of the respective obligations;
- 19 (8) Insurance company obligations. Contracts and
20 agreements supplemental thereto providing for
21 participation in one or more accounts of a life
22 insurance company authorized to do business in Hawaii,

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1 including its separate accounts, and whether the
2 investments allocated thereto are comprised of stocks
3 or other securities or of real or personal property or
4 interests therein;

- 5 (9) Interests in real property. Interests in improved or
6 productive real property in which, in the informed
7 opinion of the board, it is prudent to invest funds of
8 the system. For purposes of this paragraph, "real
9 property" includes any property treated as real
10 property either by local law or for federal income tax
11 purposes. Investments in improved or productive real
12 property may be made directly or through pooled funds,
13 including common or collective trust funds of banks
14 and trust companies, group or unit trusts, limited
15 partnerships, limited liability companies, investment
16 trusts, title-holding corporations recognized under
17 section 501(c) of the Internal Revenue Code of 1986,
18 as amended, similar entities that would protect the
19 system's interest, and other pooled funds invested on
20 behalf of the system by investment managers retained
21 by the system;

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- 1 (10) Other securities and futures contracts. Securities
2 and futures contracts in which, in the informed
3 opinion of the board, it is prudent to invest funds of
4 the system, including currency, interest rate, bond,
5 and stock index futures contracts and options on the
6 contracts to hedge against anticipated changes in
7 currencies, interest rates, and bond and stock prices
8 that might otherwise have an adverse effect upon the
9 value of the system's securities portfolios; covered
10 put and call options on securities; and stock; whether
11 or not the securities, stock, futures contracts, or
12 options on futures are expressly authorized by or
13 qualify under the foregoing paragraphs, and
14 notwithstanding any limitation of any of the foregoing
15 paragraphs (including paragraph (4)); and
- 16 (11) Private placements. Investments in institutional
17 blind pool limited partnerships, limited liability
18 companies, or direct investments that make private
19 debt and equity investments in privately held
20 companies, including but not limited to investments in
21 Hawaii high technology businesses or venture capital
22 investments that, in the informed opinion of the

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1 board, are appropriate to invest funds of the system.
2 In evaluating venture capital investments, the board
3 shall consider~~[, among other things, the impact an~~
4 ~~investment may have on job creation in Hawaii and on~~
5 ~~the state economy. The board shall report annually to~~
6 ~~the legislature on any Hawaii venture capital~~
7 ~~investments it has made; provided that if the board~~
8 ~~determines it is not prudent to invest in any Hawaii~~
9 ~~venture capital investments the board shall report the~~
10 ~~rationale for the decision. The board, by January 1,~~
11 ~~2008, shall develop criteria to determine the amount~~
12 ~~of funds that may be prudently invested in Hawaii~~
13 ~~private placement investments.] Hawaii venture capital~~
14 ~~investment opportunities unless, under the~~
15 ~~circumstances, it is not prudent to do so. In order~~
16 ~~to address these opportunities, at any given time, the~~
17 ~~board shall allocate \$100,000,000 for Hawaii venture~~
18 ~~capital investments unless, under the circumstances,~~
19 ~~it is not prudent to do so. The board may contract~~
20 ~~with one or more management companies to manage and~~
21 ~~invest these moneys. The board may enter into~~
22 ~~contracts for the provision of investment advice or~~

Report Title:

Employees' Retirement System; Innovation Capital

Description:

Authorizes the Employees' Retirement System of the State of Hawaii to invest up to \$100 million in Hawaii venture capital opportunities.

JUSTIFICATION SHEET

DEPARTMENT: Business, Economic Development, and Tourism

TITLE: A BILL FOR AN ACT RELATING TO INNOVATION CAPITAL.

PURPOSE: The Employees Retirement System (ERS) of the State of Hawaii invests its assets in many investment categories including publicly traded stocks and bonds, and alternative asset categories such as real estate, forestry, and venture capital. Of its \$400,000,000 allocation to venture capital, none is invested locally. This Act will direct the ERS to invest \$100,000,000 into venture capital funds in Hawaii companies. Hawaii-oriented investment by the ERS will result in strong returns for ERS beneficiaries, more venture capital available for Hawaii's high growth companies, and lead to expansion of Hawaii's venture capital industry. The outcome of this increased venture activity will be high-quality, high return deal flow, linkages for Hawaii companies to external markets, direct assistance for entrepreneurs in growing their companies, and expansion of professional investment expertise in Hawaii.

MEANS: Amend Section 88-119 Hawaii Revised Statutes.

JUSTIFICATION: The outcome of this measure will be the acceleration of economic diversification for the State, achieved through high-quality, high return deal flow for the ERS, linkages for Hawaii companies to external markets, direct assistance for entrepreneurs in growing their companies, and expansion of professional investment expertise in Hawaii.

Impact on the public: Increased high skilled employment opportunities.

Impact on the department and other agencies:
Accelerated growth of the high tech
industry.

GENERAL FUND: None.

OTHER FUNDS: ERS investment pool.

PPBS PROGRAM
DESIGNATION: None

OTHER AFFECTED
AGENCIES: Budget and Finance

EFFECTIVE DATE: July 1, 2008