Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

House Bill 1077 (Delegate Marriott, *et al.*)
Appropriations

Pensions - Economically Targeted Investments

This pension bill requires the Board of Trustees of the Maryland State Retirement and Pension System (MSRPS) to set an investment goal of between 5% and 10% of MSRPS assets to be invested in "economically targeted investments" (ETI). Economically targeted investment is defined as "an investment that fills a community development need that other investors have not met, and presents an opportunity to diversify a market rate portfolio or provides a market rate of return with a government risk management or subsidy program." The board of trustees is to maintain a database for evaluating the risk and return of the economically targeted investments that it makes and must report to the General Assembly by October 1, on the level of ETI activity each year, and the risk and return on each ETI investment.

This legislation also creates a seven-member Commission on Economically Targeted Investments as an independent unit of the executive branch. The commission is to study the feasibility of and mechanisms for changing the investment and other public policies of the State to enable the funds of the several systems to be used for economically targeted investments.

Fiscal Summary

State Effect: Potentially significant increase in expenditures (all fund types) for additional employer contributions resulting from diminished MSRPS investment performance, as discussed below. In addition, special fund expenditures for administrative expenses could increase by $48,000 in FY 1998, which accounts for the bill's October 1, 1997 effective date. Future years would reflect annualization and growth.

Local Effect: Significant indeterminate increase in expenditures for participating local governments for additional employer contributions resulting from diminished MSRPS investment performance, as discussed below.

Small Business Effect: Potential meaningful impact on small businesses. Small businesses that receive capital and operating funding through economically targeted investments from the pension trust fund would benefit. The number of such businesses cannot be determined at this time.

Fiscal Analysis

State Expenditures: This bill alters the current $21 billion investment portfolio of the MSRPS by setting a goal that between 5% to 10% of assets (about $1.1 to $2.1 billion) be invested in economically targeted investments. Costs associated with this proposal derive from two sources: administrative costs and diminished investment returns.

Administrative Costs

Fiscal Services estimates that the State Retirement Agency would need one additional person to administer the ETI efforts, including maintenance of the ETI database required by the bill. Currently, the Investment Division of the Retirement Agency manages $21 billion with a staff of six people. The Retirement Agency estimates that the Investment Division could implement the investment database and investment program with existing staff and resources. The Retirement Agency also estimates that it could provide staff support to the commission from existing resources. Fiscal Services, however, estimates that implementing the investment program and providing staff support to the commission together would require one additional staff member, at an annual salary of approximately $50,000. This would result in additional personnel expenditures of $47,985 for fiscal 1998, which accounts for the bill's October 1, 1997 effective date, increasing to $64,291 in fiscal 1999. This estimate includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses. Future year expenditures reflect (1) a full salary with 3.5% annual increases and 3% employee turnover; and (2) 2% annual increases in ongoing operating expenses.

Diminished Investment Returns

The MSRPS is a trust fund that receives its revenues from three sources: employer contributions, employee contributions, and investment gains. Since employee contributions are fixed, any long-term decrease in investment gains will result in additional employer contributions in order to keep the system on a sound actuarial status. (Currently, the system is 80% funded on an actuarial basis and by law must be fully funded by the year 2020.) To achieve the system's funding goals, the State's actuary has assumed a 7.5% actuarial investment rate of return. While in many years the system's return is far higher than that, the actuarial return reflects long-term financial performance by offsetting individual annual returns that may be both above and below that mark.

In 1993 the board of trustees adopted an investment policy on ETIs. That policy states that within any asset class, if the board is presented an investment opportunity that offers a rate of return acceptable to the board at reasonable risk for that investment class, and also is beneficial to the citizens of Maryland, the board will pursue that investment over similar investments that offer the same return at similar risk but do not benefit Maryland.

The bill defines an economically targeted investment as one that "presents an opportunity to diversify a market rate portfolio" or "provides a market rate of return with a government risk management or subsidy program." This language indicates that these investments are expected to generate market rate returns, either naturally or through a government risk management or subsidy program (which is assumed to be independent of the MSRPS).

If these ETIs do in fact produce market rate returns, then there would be no impact on the MSRPS. Such investments would be consistent with the MSRPS's current investment policy. Economically targeted investments, however, generally either do not provide a market rate of return, or have a greater risk factor, or both.

Given the potential magnitude of these investments (between $1.1 and $2.1 billion), any long-term disparity between the realized rate of return for ETIs and the actuarial rate of return will result in the system falling behind its schedule of full funding by 2020 and therefore require higher employer contributions. For example, the actuary estimates that a drop in investment performance of a quarter of 1 percent would increase the State's actuarial liabilities by $979 million. Amortizing these liabilities over 21 years through the year 2020 results in an annual payment of $48.8 million beginning in fiscal 1999 and increasing 5% per year until 2020.

Local Expenditures: For local governments that participate in the MSRPS, a quarter-point decline in the actuarial rate of return would increase the local governments' liabilities by $63 million. Amortizing these liabilities over 21 years through the year 2020 results in an annual payment of $3.2 million beginning in fiscal 1999 and increasing 5% per year until 2020.

Information Source(s): State Retirement Agency, Milliman & Robertson, Inc., Department of Fiscal Services

Fiscal Note History: First Reader - February 23, 1997
mld

Analysis by: Matthew D. Riven
Reviewed by: John Rixey

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 841-3710
(301) 858-3710