

Department of Fiscal Services
Maryland General Assembly

FISCAL NOTE

Senate Bill 208 (Senator Amoss)
(Chairman, Joint Committee on Pensions)
Budget and Taxation

Pensions - Expense Fund - Limitation on Investment Management Fees

This bill changes the basis upon which the Maryland State Retirement and Pension System (MSRPS) may calculate and spend off-budget funds on outside investment management services, exclusive of real estate. The MSRPS may currently spend up to 0.3% of the market value of invested assets. This bill keeps the fee limit at that level, but change the basis on which the market value of invested assets is calculated to make it more reflective of current assets.

This bill also extends for two years the sunset of the limit on off-budget funds that the MSPRS may spend on real estate investment management services. It extends from the end of fiscal 1997 to the end of fiscal 1999 the MSRPS's authority to spend up to 1.5% of the market value of invested real estate assets on outside management services, and also changes the basis on which the market value of invested assets is calculated to make it more reflective of current assets. At the end of fiscal 1999, this fee limit would revert to 1.2%.

Fiscal Summary

State Effect: Minimal impact on employer retirement contributions, as discussed below.

Local Effect: None.

Small Business Effect: Minimal impact on revenues of small businesses that provide investment management services to the MSRPS, as discussed below.

Fiscal Analysis

State Expenditures: This bill provides that the market value of non-real estate investment assets will be calculated as of the last day of the preceding quarter. Under current law, the market value of these assets is calculated as of December 31 of the previous fiscal year, making the market value data as much as 18 months old. The extent to which this bill will increase or decrease off-budget expenditures on non-real estate investment management services depends primarily on the short-term performance of the MSRPS's financial investments. If these investments increase in value between the prior December and the relevant quarter, the amount of fees that the MSRPS may pay to outside managers will increase relative to the limit under current law. If, however, investments decrease during that time, the amount of fees that the MSRPS may pay to outside managers will decrease relative to the limit under current law.

For illustrative purposes, set forth below is an estimate of the cap for non-real estate investment management fees under both current law and this bill, **assuming a 7.5% rate of return**, which corresponds to the actuarial assumption used by the MSRPS to forecast future investment returns. This return is significantly lower than the actual investment performance of MSRPS assets during fiscal 1995 and 1996; however, it does reflect a more likely average investment return over time. The assets upon which these fees are based exceed \$15 billion.

Non-Real Estate - Fiscal 1998 Investment Manager Fee Limits

<u>Current Law</u>	<u>Proposed</u>	<u>Difference</u>
\$45,055,600	\$48,076,400	\$3,020,800

For investment management fees paid to real estate advisers, the bill both updates the measure of the market value of real estate assets, as described above, and also extends the 1.5% limit on fees to these advisers for another two years. Again, for illustrative purposes, an estimate of the cap for real estate investment management fees under both current law and this bill, **assuming a 7.5% rate of return**, is set forth below. The assets upon which these fees are based exceed \$440 million.

Real Estate - Fiscal 1998 Investment Manager Fee Limits

<u>Current Law</u>	<u>Proposed</u>	<u>Difference</u>
\$6,607,100	\$7,050,100	\$443,000

If the real estate fee cap's sunset were allowed to expire and it returned to 1.2%, but its

calculation was updated as in the case of non-real estate investment fees, the fee cap would be approximately \$5,640,100, or \$967,000 less than the current limit.

In the case of both the non-real estate and real estate fee caps, these illustrations do not reflect what the MSRPS will actually pay in fees in fiscal 1998 under the proposed law, unless by coincidence the return on invested assets is 7.5% during fiscal 1998. Rather, the illustrations simply illuminate the differences that result from changing the timing of the calculation of those market assets. Because these manager fees are highly tied to the manager's investment performance, any effect from a change in such fees on employer contributions is expected to be minimal.

Small Business Effect: The Retirement Agency estimates that of its approximately 26 outside investment managers (including both real estate or non-real estate), between 1 and 3 of them may qualify as small businesses. It cannot be determined at this time, however, whether these small businesses will receive more revenue under the proposed bill.

Information Source(s): State Retirement Agency, Department of Fiscal Services

Fiscal Note History: First Reader - January 21, 1997

ncs

Analysis by: Matthew D. Riven

Reviewed by: John Rixey

Direct Inquiries to:

John Rixey, Coordinating Analyst

(410) 841-3710

(301) 858-3710