HB 163

Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE

House Bill 163 (Delegate Proctor) (Chairman, Joint Committee on Pensions)
Appropriations Budget and Taxation

Retirement and Pensions - Quarterly Estimate of Manager Fees - Alternative Investment Managers

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This pension bill increases the fee limits that the board of trustees of the State Retirement and Pension System (SRPS) may pay for the external management of alternative investments. The bill also allows the pension board to carryover from one quarter to the next any previously estimated but unspent fees under the fee limit cap for alternative investments or real estate investments.

The bill takes effect July 1, 2002 and applies retroactively for the previous eight quarters of unspent fees under the cap.

Fiscal Summary

State Effect: None. The bill affects the internal investment operations of the SRPS but should not directly affect State expenditures or revenues.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: Fees paid to managers of alternative investments -- such as venture capital, private equity, and leveraged buyouts -- are included in the fee cap for externally managed non-real estate investments. This fee cap is calculated as 0.3% (or 30 basis points) of the market value as of the last day of the preceding quarter of externally invested non-real estate assets.

Fees paid to managers of real estate investments are subject to a fee cap that is calculated as 1.2% (or 120 basis points) of the market value as of the last day of the preceding quarter of externally invested real estate assets.

Background: The existing fee caps limit the amount that the pension board can pay to outside investment managers. For fiscal 2001, the board paid these managers approximately $65 million in management fees. These fee payments are not included in the State budget nor are they subject to review by the Board of Public Works, so the fee cap structure is the only statutory or legislative control over the amount of such payments.

While the board may negotiate separate fee structures with each external manager, in aggregate, non-real estate fee payments may not exceed the 30 basis points. In general, the pension board follows the industry practice of negotiating fees with its external managers based as a percentage of assets. The board argues, however, that alternative investments tend to have unique fee structures with profit-sharing features and annual management fees based on committed capital rather than invested capital. The board notes that the average management fee currently paid to its alternative investment managers is 90 basis points of committed capital plus profit-sharing arrangements ranging from 10% to 20%. Excellent performance from this asset class could therefore push total non-real estate manager fees above the 30 basis point cap; alternatively, the board would be forced to scale back its investments in this class.

The pension board therefore initially requested legislation that would entirely exempt its fee structure for external management of alternative investments from any fee cap. The Joint Committee on Pensions agreed that the 30 basis point fee structure may not be appropriate for external managers of alternative investments; however, the joint committee declined to exempt this asset class from any fee cap. Instead, the joint committee proposes increasing the fee limit for this asset class, and allowing unused fee cap room (for both real estate and alternative investments) to be carried over from year to year so that sufficient spending authority is retained to cover payment of any profit-sharing arrangements.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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