Department of Legislative Services

Maryland General Assembly
2002 Session

FISCAL NOTE

House Bill 1413 (Delegate D'Amato)
Appropriations

Retirement and Pensions - Administration

This pension bill imposes several restrictions on the investment practices of the State Retirement and Pension System (SRPS).

The bill takes effect July 1, 2002.

Fiscal Summary

State Effect: The negative impact on SRPS operations and investment performance, and hence State pension contributions, cannot be reliably estimated at this time, but could be significant. Additional State Retirement Agency staff and administrative expenses could be required to comply with the bill's requirements.

Local Effect: Employer pension contributions by governmental units that participate in SRPS would increase if future investment returns are reduced.

Small Business Effect: None.

Analysis

Bill Summary: The bill requires the pension system to make four changes to its investment practices:

- Trustees of SRPS would be prohibited from serving on the board of any company in which any of the system assets are invested or from investing the trustee's personal assets in any company in which any of the assets of the several systems are invested.

- The system would be required to publicly disclose (within 48 hours) the material facts of any investment transaction involving any of the system assets of the several systems, with the disclosure to be made available at the State Retirement Agency and posted on the agency's web site.
- The system would be required to disclose a list of all international companies in which any system assets are invested and that have engaged in business transactions with any nation: (a) upon which the Security Council of the United Nations has imposed sanctions in accordance with Chapter VII of the United Nations charter; or (b) that the United States has recognized as having engaged in the proliferation of, or the development of delivery systems for, weapons of mass destruction.
- The board of trustees would be prohibited from hiring any State employee or officer to invest any of the assets of the pension system.

Current Law: The 14-member Board of Trustees for SRPS (5 ex-officio members, 6 elected members, and 3 appointed members) is responsible for the oversight and management of the system. Each trustee is a fiduciary who, by law, is to serve and carry out his or her duties as a trustee solely in the interest of the members, retirees, and beneficiaries of the various systems. The board is given "full power" under pension law to invest and re-invest the system assets. They are required to do so, "with the care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims…"

Under current law, a trustee may not: (1) use system assets in the trustee's own interest or account; (2) act in a transaction involving the system for another person or persons whose interests are adverse to the membership of the system; (3) receive any type of payment or considerations from a person dealing in transactions with system assets; and (4) become an endorser or surety or an obligor for monies borrowed or lent from the board. Each trustee is charged with using reasonable care to prevent another trustee from committing a breach in his or her fiduciary responsibilities.

State Expenditures: The bill's provisions would have a significant impact on the pension board's investment operations.

The first provision would effectively prohibit any personal investments by board trustees, because the board holds investments in all the largest domestic publicly traded securities, and many international ones as well. This restriction could deter individuals from serving on the pension board. The impact on the board's operations, including investment operations, cannot be reliably estimated at this time.

The second provision would require the board to disclose within 48 hours the several thousand transactions a year that the board conducts. The system is involved in 40,000 to 70,000 transactions per year. The administrative burden (e.g., additional overtime or contractual personnel expenditures) from complying with the requirement is likely to be high; however, the cost of such compliance cannot be reliably determined at this time. In addition, the requirement could permit "market-watchers" to determine the direction of any shift in the board's investment policies and allow such traders to "front-run," driving up the cost of the system's transactions.

The third provision would require the board to disclose certain international transactions. The administrative burden from complying with the requirement (e.g., additional investment division staff to monitor the international portfolio) is likely to be high; however, the cost of such compliance cannot be reliably determined at this time. It should be noted that the system's international portfolio is entirely externally managed. Thus, there would be compliance burdens on the system's external managers. To the extent that managers refuse to do business with Maryland because of the disclosure requirements, the system's investment performance could suffer. The impact on the system, and corresponding effect on State pension contributions, if the system were required to shift to different external managers, would depend on the risk-adjusted return of the new investments compared to the current investments. For illustrative purposes, the State's pension actuary informally estimates that for each 1% return below the 8% actuarially assumed investment return, the State's pension contributions increase by approximately $16 million annually.

The final provision would require the system to terminate its internal investment staff, who as State employees would be prohibited from investing system assets. The system currently employs 11 people in its investment division, with total salaries of approximately $900,000 and other personnel and administrative expenses. The staff manages the system's passive (indexed) investments (valued at approximately from $9 billion to $10 billion) and oversees the external managers. Eliminating the staff would require the system to employ additional external managers, as well as additional consultants to oversee the managers. The resulting fiscal impact cannot be reliably estimated, but external management of indexed investments is likely to be more expensive than the current structure.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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Analysis by: Matthew D. Riven

Direct Inquiries to:
John Rixey, Coordinating Analyst
(410) 946-5510
(301) 970-5510