SB 340

Department of Legislative Services

Maryland General Assembly
2003 Session

FISCAL AND POLICY NOTE

Senate Bill 340 (Senator Hogan, *et al.*)
Budget and Taxation

Maryland Technology Investment Program

This pension bill creates a Maryland Technology Investment Program. The program mandates venture capital investments by the State Retirement and Pension System (SRPS) in technology or bioscience businesses and parks in the State. Criteria for these investments are specified in the bill. The program requires SRPS to invest $100 million ($20 million per year over five years) in these businesses and business parks. To the extent that each disbursement fails to earn the SRPS's actuarially assumed rate of return, the State would be required to appropriate to SRPS the difference between the assumed and the actual return.

The bill takes effect June 1, 2003.

Fiscal Summary

State Effect: The impact on State expenditures cannot be reliably estimated at this time and would depend on the investment performance of the mandated investments. To the extent that these investments earn a return lower than the 8% actuarial assumption, then the State would be required to appropriate to SRPS the difference, with a maximum State general fund appropriation of approximately $171 million over five years (the initial $100 million investment plus 8% annual return) beginning in FY 2011.

This potential loss does not reflect the implied loss to the system of any foregone returns above 8%. To the extent that these investments earn a return higher than the investments that SRPS would have otherwise chosen, then State employer pension contributions would decline proportionally. (Given the small proportion of the investments in relation to the total size of SRPS, any increase or decrease in employer contributions is likely to be minimal.)

Local Effect: Governmental units that participate in SRPS would experience the same investment results discussed above for the State.

Small Business Effect: Meaningful impact for small businesses that meet the definition for qualified technology or bioscience businesses or technology or bioscience parks and could not otherwise obtain financing.

Analysis

Bill Summary: The program will be administered by the Board of Trustees of SPRS. The board, in consultation with the Maryland Technology Development Corporation, will establish and administer the program and adopt regulations as necessary to implement the program.

To qualify as an eligible "qualified technology or bioscience business," a business must meet the following criteria.

Corporate status: The business must: (1) be headquartered in the State and must intend to remain in the State after receipt of the investment, or be headquartered in another state and intend to relocate its headquarters to the State after receipt of the investment; and (2) have its principal business operations located in the State and intend to maintain business operations in the State after receipt of the investment, or have its principal business operations located in another state, and intend to relocate business operations to the State within 90 days after receipt of the investment. Alternatively, the business may be a subsidiary in the State, of a business headquartered outside the United States.

Purpose of investment: The business must agree to use the qualified investment primarily to: (1) support business operations in the State; or (2) in the case of a start-up business, establish and support business operations in the State.

Size of business: The business may not have more than 100 employees and must: (1) employ at least 80% of its employees in the State; or (2) pay 80% of its payroll to employees in the State.

Sector of business: The business must be primarily engaged in: (1) manufacturing, processing, or assembling technology or bioscience products; (2) conducting technological or bioscience research and development; or (3) providing technology or bioscience related services.

Restrictions on business: The business may not be primarily engaged in retail sales, real estate development, the business of insurance, banking, or lending, or the provision of professional services provided by accountants, attorneys, or physicians.

A "qualified technology or bioscience park" is defined as a business entity affiliated with an institution of higher education located in the State that offers: (1) physical infrastructure in the State, including office space, for the operation of a technology or bioscience company; or (2) company development services in the State that encourage and support the start-up, incubation, and growth of innovative technology and bioscience companies with good growth potential.

In administering the program, the pension board must enter into partnership agreements with one or more venture capital general partners. Each venture capital general partner with which the pension board trustees contracts must: (1) seek investments in qualified technology and bioscience businesses and qualified technology and bioscience parks; (2) negotiate the terms of investment in the qualified technology and bioscience businesses and qualified technology and bioscience parks; and (3) monitor the progress of the investment in qualified technology and bioscience businesses and qualified technology and bioscience parks.

The pension board must ensure that: (1) a decision to enter into a partnership with a venture capital general partner is based solely on the potential for investment returns; (2) the amount of funds invested by the pension board in a partnership through the program is equal to the investment made by other institutional investors in the partnership; and (3) each venture capital general partner makes a substantial investment in the partnership.

On or before July 15 of each fiscal year beginning with fiscal 2004 and ending after fiscal 2008, the board of trustees must invest $20 million in the program. Any investment return from the program would accrue to SRPS.

Seven years after each disbursement, if the internal rate of return from the seven-year's-prior investment does not meet or exceed an 8% annualized return, the Governor would be required to include in the annual budget bill, an appropriation to SRPS that represents the difference between an 8% annualized return and the actual return of the fiscal 2004 investment in the program. For instance, in fiscal 2011, if the internal rate of return from the fiscal 2004 investment does not meet or exceed an 8% annualized return, an appropriation would be required that represents the difference between an 8% annualized return and the actual return of the fiscal 2004 investment in the program. This process would continue through fiscal 2015, regarding the investments that were made in fiscal 2008.

On July 15 of each year, the pension board, in consultation with the Maryland Technology Development Corporation, must submit a report to the Governor and the General Assembly on the implementation and administration of the program. For each fiscal year in which investments were made through the program, the report made by the pension board must include: (1) a list of investments; (2) the internal rate of return of each investment; and (3) the aggregate investment returns of all investments. The report made by the board of trustees must include an analysis of the economic impact on the state of all investments made through the program.

Current Law: None applicable. There are no investment classes into which the board of trustees of SRPS is required to invest.

Regarding the board of trustees' duties in investing SRPS assets, State law requires that a board member owes a fiduciary duty to SRPS. The law further requires that a fiduciary shall discharge the fiduciary's duties with respect to the several systems solely in the interest of the participants and as follows: (1) for the exclusive purposes of providing benefits to the participants and for reasonable expenses of administering the several systems; (2) 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; (3) by diversifying the investments of the several systems so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; (4) in accordance with the laws governing the several systems; and (5) in accordance with the documents and instruments governing the several systems to the extent that the documents and instruments are consistent with this subtitle.

State law further provides that the board may invest assets of the several systems subject to the conditions that it imposes on itself, except that not more than 25% of the assets that the board of trustees invests in common stocks may be invested in nondividend paying common stocks.

Background: In the last few years, the pension board has included in its asset allocation program a class of investment categorized as "alternative investments." This class includes limited partnerships that invest in private equity, venture capital, leveraged buyouts and opportunistic real estate development and rehabilitation. In its asset allocation policy, the board has set a range of 0 – 2% for private equity, with a target of 1%.

The pension board has committed $250 million (approximately 1% of total assets) to three private equity external investment managers: Abbott Capital – Fund II, Adams Street Partners, and Harbour Vest Partners VI. To date, $89.6 million of the $250 million has been disbursed.

State Expenditures: The impact on State expenditures cannot be reliably estimated at this time and would depend on the investment performance of the mandated investments. To the extent that these investments earn a return lower than the 8% actuarial assumption, then the State would be required to appropriate to SRPS the difference, with a maximum

State general fund appropriation of approximately $171 million over five years (the initial $100 million investment plus 8% annual return) beginning in fiscal 2011.

This potential loss does not reflect the implied loss to the system of any foregone returns above 8%. To the extent that these investments earn a return higher than the investments that SRPS would have otherwise chosen, then State employer pension contributions would decline proportionally. (Given the small proportion of the investments in relation to the total size of SRPS, any increase or decrease in employer contributions is likely to be minimal.)

The State Retirement Agency advises that it does not have sufficient staff expertise to implement and monitor this program, and cannot quantify the additional expenses needed to implement it. Legislative Services notes that the agency has an investment staff that currently oversees its existing alternative investments, and advises that SRPS could handle the investment and reporting requirements with existing budgeted resources.

Additional Comments: It is unlikely that given the June 30, 2003 effective date of the bill, that SRPS could invest $20 million in the program by July 15, 2003, as required under the bill.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Milliman USA, Department of Business and Economic Development, Maryland State Retirement Agency, Department of Legislative Services

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Analysis by: Matthew D. Riven

Direct Inquiries to:
(410) 946-5510
(301) 970-5510