

**Department of Legislative Services**  
Maryland General Assembly  
2004 Session

**FISCAL AND POLICY NOTE**

Senate Bill 214  
Budget and Taxation

(Senator Hogan)

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**Maryland Technology Investment Program**

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This pension bill creates a Maryland Technology Investment Program (MTIP). The program mandates venture capital investments by the State Retirement and Pension System (SRPS) in technology or bioscience businesses 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. 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, 2004.

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**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 7.75% actuarial assumption, then the State would be required to appropriate to SRPS the difference, with a maximum State general fund appropriation of approximately \$168.6 million over five years (the annual \$20 million investments plus a 7.75% compounded annual return) beginning in FY 2012.

This potential loss does not reflect the implied loss to the system of any foregone returns above 7.75%. Conversely, 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. 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 that the State does as a result of MTIP.

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

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## Analysis

**Bill Summary:** The program will be administered by the Board of Trustees of SRPS. The board, in consultation with the Maryland Technology Development Corporation (TEDCO), 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 U.S.

*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.

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; (2) negotiate the terms of investment in the qualified technology and bioscience businesses; and (3) monitor the progress of the investment in qualified technology and bioscience businesses.

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.

By July 15 of each fiscal year beginning with fiscal 2005 and ending after fiscal 2009, the board of trustees must invest \$20 million in the program. If the board does not find sufficient qualified investment opportunities in any one of the five fiscal years during which it is to make the annual \$20 million commitment, the portion of that year's \$20 million installment that was not invested is to be rolled into the next year's investment in this 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 years' prior investment does not meet or exceed a 7.75% annualized return, the Governor would be required to include in the annual budget bill, an appropriation to SRPS that represents the difference between a 7.75% annualized return and the actual return of the fiscal 2004 investment in the program. For instance, in fiscal 2012, if the internal rate of return from the fiscal 2005 investment does not meet or exceed a 7.75% annualized return, an appropriation would be required that represents the difference between a 7.75% annualized return and the actual return of the fiscal 2005 investment in the program. This process would continue through fiscal 2016, regarding the investments that were made in fiscal 2009.

On July 15 of each year, the pension board, in consultation with TEDCO, 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; and (2) 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% – 3% for private equity, with a target of 2%. The board will be hiring a private equity consultant in March 2004 to assist in reaching the 2% target allocation.

The pension board has committed \$250 million (approximately 0.8% of total assets) to three private equity external investment managers: Abbott Capital – Fund II, Adams Street Partners, and Harbour Vest Partners VI. To date, \$122.3 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 7.75% actuarial assumption, then the State would be required to appropriate to SRPS the difference, with

a maximum State general fund appropriation of approximately \$168.6 million over five years (the annual \$20 million installments plus 7.75% compound annual return) beginning in fiscal 2012.

This potential loss does not reflect the implied loss to the system of any foregone returns above 7.75%. Conversely, 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. The Department of Legislative Services advises that the agency has an investment staff that currently oversees its existing alternative investments, that SRPS will be hiring a consultant to assist in its existing private equity program, and that SRPS could handle the investment and reporting requirements with existing budgeted resources.

**Additional Comments:** Given the bill's June 1, 2004 effective date, it is unlikely that SRPS could invest \$20 million in the program by July 15, 2004, as required under the bill.

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### **Additional Information**

**Prior Introductions:** In 2003, SB 340, a similar bill, was referred to the Budget and Taxation Committee and no action was taken.

**Cross File:** None.

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

**Fiscal Note History:** First Reader - March 12, 2004  
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