

Department of Legislative Services

Maryland General Assembly

2008 Session

FISCAL AND POLICY NOTE

Revised

Senate Bill 606

(Senator Pugh, *et al.*)

Finance and Budget and Taxation

Health and Government Operations

**State Government - Brokerage and Investment Management Services - Use of
Minority Business Enterprises**

This bill requires the State Treasurer, the Maryland Automobile Insurance Fund, the Injured Workers' Insurance Fund, and the State Retirement and Pension System to attempt to use minority business enterprises (MBE) to the greatest extent feasible to provide brokerage and investment management services. The four entities' use of MBEs must be consistent with MBE purchasing standards in current law and with their respective fiduciary responsibilities. The bill also requires the four entities to work with the Governor's Office of Minority Affairs (GOMA) to develop guidelines to implement the bill's provisions and to submit annual reports to GOMA and the General Assembly on their use of MBE brokerage and investment firms and their efforts to encourage greater use of MBE firms. Those efforts must include the use of a wide variety of media, including their web sites, to publicize the brokerage and investment management services they use.

Fiscal Summary

State Effect: General, special, and nonbudgeted fund revenues from investment returns for funds managed by the Treasurer, MAIF, IWIF, and SRPS could increase or decrease slightly in the short term due to increased use of minority- and women-owned firms. Long-term fiscal effects on investment returns would likely be either neutral or positive.

Local Effect: Investment returns for the Local Government Investment Pool managed by the Treasurer could increase or decrease slightly in the short term due to increased use of minority- and women-owned firms. Long-term fiscal effects on investment returns would likely be either neutral or positive.

Small Business Effect: Meaningful for minority- and women-owned brokerage and investment firms.

Analysis

Current Law/Background: The State Treasurer's Office is the procurement control agency for all banking, financial services, and insurance services contracted by State agencies. The Treasurer is responsible for investing unexpended or surplus funds over which it has custody in low-risk investment instruments such as Treasury bills, repurchase agreements, highly rated commercial paper, and money market funds. It also manages a Local Government Investment Pool on behalf of participating local governments. Investment guidelines for the pool are the same as those for State funds. As of January 2008, the Treasurer's investment portfolio totaled \$7.6 billion. The fund balance for the Local Government Investment Pool was \$1.9 billion. All assets are managed in-house by the Treasurer's staff, with collateral held by M&T Bank, the State's designated safekeeper of funds. The Treasurer must invest funds with the care, skill, prudence, and diligence that a prudent person would use.

The Maryland Automobile Insurance Fund is an independent State agency that was established in 1972 to provide automobile liability insurance to Maryland residents who are unable to obtain coverage in the private insurance market. The fund's revenues come entirely from insurance premiums and investment income. The fund's investment portfolio has assets of approximately \$375 million, of which roughly 75% are invested in fixed income assets and 25% are in equities. All assets are managed by five external investment firms, none of whom qualify as an MBE.

The Injured Workers' Insurance Fund is an independent entity governed by a board of nine directors (appointed by the Governor to five-year terms). IWIF's primary purpose is to provide workers' compensation insurance to Maryland-based businesses that do not wish, or are not allowed, to self-insure. Financing for IWIF is derived solely from its premium and investment income. IWIF's investment portfolio is comprised of bonds and other fixed income vehicles. About two-thirds of the portfolio is managed in-house, and one-third is managed by external investment firms. IWIF reports that none of its current external managers qualify as MBEs. In calendar 2007, IWIF reported total assets of \$1.5 billion.

The State Retirement and Pension System is guided by a 14-member Board of Trustees and is responsible for administering the State's retirement and pension systems. Trustees act as fiduciaries for the system, which requires them to invest assets in a prudent fashion and solely for the benefit of members and beneficiaries. Among the system's four

fundamental goals for its operation is a goal to “prudently invest system assets in a well-diversified manner that optimizes long-term returns while controlling risk.” As of June 30, 2007, the system’s assets totaled \$39.4 billion.

In fiscal 2007, the SRPS board approved the creation of an Emerging Managers program whose purpose is to invest a portion of the system’s assets with small and minority-owned investment managers. As of December 31, 2007, the program included nine investment managers and a total portfolio of \$368 million, or 0.9% of the system’s assets. Over its very brief lifespan, the program has outperformed both the S&P 500 index and the Maryland Emerging Managers index, and the board expects the program to grow.

The Governor’s Office of Minority Affairs is a subcabinet agency within the Executive Department whose purpose is to strengthen and advocate on behalf of Maryland’s minority- and women-owned businesses. It oversees the State’s MBE program and provides technical assistance to MBEs and procurement officers.

The State’s MBE program establishes a goal that at least 25% of the total dollar value of each agency’s procurement contracts be awarded to MBEs, including 7% to African American-owned businesses and 10% to women-owned businesses. There are no penalties for agencies that fail to reach these targets. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurement.

A minority business enterprise (MBE) is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

MBEs include not-for-profit entities organized to promote the interests of physically or mentally disabled individuals.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State’s MBE certification agency to be socially and economically disadvantaged.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of their membership in a

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group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million is not considered economically disadvantaged.

State Fiscal Effect: The bill's fiscal impact revolves around whether minority- and women-owned investment firms can provide, at a minimum, the same level of service and investment returns as current investment managers. This depends entirely on the availability of minority- and women-owned investment firms and the relative returns generated by those firms. The MBE disparity study conducted for the State in 2006 by NERA Economic Consulting did not assess the availability of minority- and women-owned investment firms in Maryland. SRPS' experience with its emerging manager program indicates that such firms are available, but, as a group, may not have the capacity to manage as much as 25% of assets under management, consistent with the MBE program's goal. Although the performance of managers in the program has exceeded market indices to date, the program has been in place for less than one year, which is not sufficient time to gauge its long-term performance compared with more established firms.

Assuming that MAIF, IWIF, and the Treasurer's Office follow the SRPS example and institute a pilot program of MBE firms, the bill's short-term fiscal effect is likely to be small and could be either positive or negative. In the long term, it is doubtful that any of these entities would expand a pilot program if it did not, at a minimum, match the performance of current managers. In particular, any expansion of the SRPS Emerging Manager Program that was projected to have a negative effect on investment returns would be precluded by the board's fiduciary responsibilities to system members. The Treasurer, too, would be precluded from investing in any manner that violated the "prudent person" standard included in statute. And, under the bill's provisions, the entities must use MBEs consistent with their fiduciary responsibilities. Therefore, Legislative Services projects that, in the long term, the bill would have either no effect or a positive effect on investment returns.

GOMA's advisory role under the bill is consistent with its mission and current role as provider of technical assistance to State agencies regarding efforts to achieve the MBE program goals. Legislative Services does not envision that the bill's requirement that GOMA consult with the four affected entities would require additional staff or resources.

Local Fiscal Effect: As participants in the Local Government Investment Pool managed by the Treasurer, local governments could experience the same short-term positive or

negative fiscal effects as the State. Long-term effects are projected to be neutral or positive.

Small Business Effect: Most MBEs are small businesses. By requiring SRPS, MAIF, IWIF, and the Treasurer to make an effort to employ more minority- and women-owned brokerage and investment firms, the bill will directly benefit small businesses that meet the MBE definition and provide brokerage or investment management services.

Additional Information

Prior Introductions: None.

Cross File: HB 1277 is identified as a cross file, but was somewhat different as introduced. Both bills have been amended to be identical.

Information Source(s): Injured Workers' Insurance Fund; Governor's Office; Maryland Insurance Administration; Department of Labor, Licensing, and Regulation; Department of Legislative Services

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