SB 178

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 178	(Senator McFadden)(Chair, Joint Committee on Pensions)
Budget and Taxation	Appropriations

State Retirement and Pension System - Investments

This bill raises the cap on management fees that the Board of Trustees of the State Retirement and Pension System (SRPS) can pay to external asset managers, not including managers of real estate and alternative assets, from 0.3% to 0.5% of the market value of the managed assets. It also clarifies the authority of the SRPS chief investment officer (CIO) to invest in alternative investment vehicles and select external investment managers.

The bill takes effect July 1, 2009.

Fiscal Summary

State Effect: No effect on State pension liabilities or contribution rates. No effect on revenues.

Local Effect: None.

Small Business Effect: None.

Analysis

Current Law: The SRPS Board of Trustees must calculate the fee cap on a quarterly basis. The cap may not exceed 0.3% (30 basis points) of one-quarter of the total market value of the externally managed assets, not including real estate and alternative assets. There is no fee cap for externally managed real estate and alternative assets.

Chapter 368 of 2007 gave the CIO sole authority to hire and fire external investment managers in accordance with strategic asset allocation targets established by the board.

Background: As of December 31, 2008, SRPS assets totaled $24.8 billion, of which $21.0 billion was invested in equities and fixed income. All SRPS assets are externally managed by asset managers selected by the chief investment officer of the State Retirement Agency. All asset management fees are paid from pension fund assets.

Prior to fiscal 2009, the board was subject to two separate fee caps: the current 0.3% fee cap for equities and fixed income and a 1.2% (120 basis points) cap for externally managed real estate and alternative assets. However, Chapter 506 of 2008 repealed the real estate/alternative fee cap.

In January and September 2008, the board approved two separate changes to its strategic asset allocation. The changes decrease the system's allocation to public equity and fixed income and increase its exposure to alternative asset classes. As a result, the system reduced its public equity allocation target from 63% of total assets to 39% of total assets, and the fixed income allocation target from 27% of total assets to 15% of total assets. At the same time, the board expanded its emerging asset manager program (since renamed the Terrae Mariae program), equally distributed its public equity portfolio between domestic and international stocks (instead of favoring domestic stocks), and expanded its real return class to include commodities and infrastructure investments. Each of these last three measures may have significant implications for equity and fixed income fees, since some emerging managers, international equity managers, and real return managers charge fees in excess of 30 basis points. SRA reports that 14 of the system's 35 public equity and fixed income managers charge fees that exceed 30 basis points.

In fiscal 2008, the annual fee cap exceeded fees paid to managers subject to the cap by $21.5 million (based on $83.6 million in total fees paid). Through the first two quarters of fiscal 2009, the fee cap exceeds fees paid to eligible managers by $14.5 million.

State Fiscal Effect: Legislative Services does not expect fees paid by the system to exceed the current cap for several years. Therefore, the fee cap increase should not affect pension fund assets or employer contribution rates within the five-year timeframe covered by fiscal and policy notes. Based on fiscal 2008 asset levels, the increase from 30 to 50 basis points will increase the cap amount by about $70 million. However, there is sufficient room beneath the current cap to allow for significant growth in management fees before they exceed the current cap.

Legislative Services also notes that the likely increase in fees paid in the coming years is driven by a shift to asset subclasses and managers that, for the most part, have outperformed broad domestic stock and bond indices in recent years. To the extent that those trends continue, any increase in fees could be offset by increased returns.

The provisions affecting the CIO's authority conform statute to the legislative intent of Chapter 368 of 2007.

Additional Information

Prior Introductions: None.

Cross File: HB 448 (Delegate Griffith, *et al.*) (Chair, Joint Committee on Pensions) - Appropriations.

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

Fiscal Note History: First Reader - February 15, 2009
ncs/rhh Revised - Senate Third Reader - March 31, 2009

Analysis by: Michael C. Rubenstein

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