Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

Senate Bill 982 (Senators Kasemeyer and Miller)
Budget and Taxation Appropriations

State Retirement and Pension System - Private Equity and Venture Capital Investments

This bill authorizes the Board of Trustees of the State Retirement and Pension System (SRPS) to enter into an agreement with the Maryland Technology Development Corporation (TEDCO) or another entity to make and manage investments on behalf of the board in private equity and venture capital in the State. It also expresses legislative intent that State contributions to the pension fund in excess of statutory requirements be invested in the State with a goal to increase the risk capital available in the State as long as the investments are consistent with, and do not compromise or conflict with, the SRPS board's fiduciary duties. Any entity providing investment services to the board under the bill is subject to the same standards of care and prohibited transactions to which the board is subject under current law.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: The bill's effect on pension liabilities and contributions is contingent on the Governor providing additional State contributions to the pension fund above those required by statute and will vary depending on the performance of investments made with those funds. The FY 2017 budget includes $25.0 million that is in excess of mandated amounts and, therefore, is subject to the bill. The investments authorized by the bill may result in investment returns that are either higher or lower than they otherwise would be if the system elected to invest the money differently. State pension liabilities and contribution rates increase or decrease according to the performance of those investments.

Local Effect: None. The bill relates only to the investment of State funds by SRPS.

Small Business Effect: Minimal. Some small businesses may benefit from investments authorized by the bill.

Analysis

Bill Summary: "Private equity" is defined as an asset class consisting of equity securities and debt in operating companies that are not publicly traded on a stock exchange. "Venture capital" is defined as an investment of capital to a business at any stage of its development before the business makes a public offering of stock. An "investment in the State" includes an investment in an entity or vehicle that (1) is domiciled in the State; (2) operates in the State; or (3) is reasonably expected to invest in entities that are in the State.

Under the terms of an agreement with the SRPS board, TEDCO or another entity may invest funds that are in excess of:

- mandated State employer contributions on behalf of State employees and teachers based on actuarial calculations of the amount necessary to fully fund the State's pension obligations;
- the $75.0 million supplemental contribution to the system that is paid by the State until the system reaches a funding level of 85%;
- employer contributions by participating governmental units in SRPS;
- contributions by local school boards to cover the normal cost payments for their employees who are members of the Teachers' Retirement System or Teachers' Pension System;
- the additional State payment to the system, up to $50.0 million annually, required through fiscal 2020 when the unappropriated general fund surplus exceeds $10.0 million (the "sweeper" payment); and
- any other amounts required to be paid to the pension system by statute.

If the board does not enter into an agreement with TEDCO or another entity, the board must develop a process that authorizes TEDCO or another entity to provide recommendations regarding investments in private equity and venture capital in the State using the funds specified above. The investments or recommendations made by TEDCO or another entity must include a goal of investments or recommendations for the investment of 50% of the available funds in commercialization of technology sponsored or created by a university in the State.

The bill specifies that the board or any other fiduciary may not be held liable for any actions taken or decisions made in good faith to comply with the bill. It also requires the board to act in good faith to carry out the bill in accordance with all applicable laws and judicial decisions. However, the bill does not require the board to take action unless it determines, in good faith, that the action is consistent with its fiduciary responsibilities. The bill includes an annual reporting requirement for the board and a second annual reporting requirement for TEDCO or any other entity that enters into an agreement with the board under the bill.

Current Law: The SRPS Board of Trustees consists of 15 members who are fiduciaries of the system. The board holds the assets of the system for the exclusive purpose of providing benefits to participants and for reasonable expenses of administration. As fiduciaries, the members of the board are subject to standards of care that require them to discharge their duties:

- solely in the interest of participants;
- for the exclusive purpose of providing benefits to participants and for reasonable expenses;
- with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would use;
- by diversifying the investments of the system to minimize the risk of large losses, unless under the circumstances it is not prudent to do so;
- in accordance with the laws governing the system; and
- in accordance with documents and instruments governing the system to the extent that they are consistent with State law.

Fiduciaries of the system are prohibited from:

- using the system's assets for their own interest or account;
- acting in a transaction on behalf of a person whose interests are adverse to the interests of the system or the interests of participants;
- receiving any consideration from a person dealing with the system in connection with a transaction involving system assets; and
- becoming an endorser or surety or, in any manner, an obligor for money lent to or borrowed from the board.

The board's Investment Committee is charged with advising the board and making recommendations on the investment program, among other matters. Under the leadership of the chief investment officer (CIO), the Investment Division of the State Retirement Agency invests the system's assets. Among other duties, the CIO is responsible for hiring external managers to invest the system's assets, selecting and investing in specified investment vehicles, and terminating external managers.

Background: As of June 30, 2015, SRPS had total assets of $45.8 billion, of which $3.7 billion (8.0%) was invested in private equity. The system does not have a venture capital allocation. However, in 1992 the system launched a Maryland Venture Capital Trust with a $15.0 million allocation. The trust was charged with investing in Maryland-based companies. All disbursements have been made by the trust, and it is no longer operational. Performance data is not available, but the trust is generally viewed as having performed poorly.

The fiscal 2017 operating budget includes a $25.0 million State contribution to SRPS in excess of all statutory requirements. Those funds would be available for investment under the bill.

In October 2015, the U.S. Department of Labor (DOL) revised its guidance related to economically targeted investments (ETIs) for trustees of pension plans subject to the Employee Retirement Income Security Act (ERISA). Although SRPS, like all other public pension plans, is not subject to ERISA, its fiduciary standards closely mirror ERISA's fiduciary standards. As defined by DOL, ETIs are investments that are selected for the economic benefits they create in addition to the investment return they provide. Many ERISA plans had interpreted DOL's prior guidance from 2008, which was withdrawn and replaced by the new guidance, as either prohibiting or strongly advising against investing in ETIs. The new guidance clarifies, among other things, that fiduciaries may invest in ETIs based, in part, on their collateral benefits as long as the investment is economically equivalent with respect to return and risk to investment without collateral benefits.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland State Retirement Agency, U.S. Department of Labor, Department of Legislative Services

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