SB 914

Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 914 (Senator Guzzone)
Budget and Taxation

State Retirement Agency - Investment Division Personnel

This bill authorizes the Board of Trustees of the State Retirement and Pension System (SRPS) to (1) create professional investment positions in the Investment Division; (2) determine the qualifications and compensation for *all* professional investment staff, including newly created positions; and (3) include expenses for *all* professional investment positions in the calculation of investment management fees, which are nonbudgeted.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: State Retirement Agency (SRA) special and reimbursable fund expenditures decrease by a combined $3.6 million in FY 2018, and SRA nonbudgeted expenditures increase by $5.8 million, reflecting the shift of current and new Investment Division staff to nonbudgeted status. Out-year expenditures reflect normal increases in compensation. State payments of administrative fees to SRA decrease by $1.2 million in FY 2018, with the savings assumed to be allocated 60% general funds, 20% special funds, and 20% federal and other funds. Over time, State pension contributions (all funds) increase annually by about the same amount as the increase in nonbudgeted expenditures. However, any increase in nonbudgeted expenditures may be offset in the out-years by increased internal management of pension funds by the Investment Division. No effect on revenues.

(in dollars)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revenues	$0	$0	$0	$0	$0
GF Expenditure	(734,200)	(749,500)	(779,100)	(810,000)	(842,300)
SF Expenditure	(2,620,100)	(2,674,700)	(2,780,200)	(2,890,500)	(3,005,800)
FF Expenditure	(244,700)	(249,800)	(259,700)	(270,000)	(280,800)
GF/SF/FF Exp.	-	-	-	-	-
NonBud Exp.	5,849,100	6,674,100	6,818,900	6,970,400	7,128,800
ReimB. Exp.	(1,223,700)	(1,249,200)	(1,298,400)	(1,349,900)	(1,403,800)
Net Effect	($1,026,300)	($1,750,800)	($1,701,600)	($1,650,100)	($1,596,200)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local payments of administrative fees to SRA decrease by approximately $2.4 million in FY 2018 due to the reduction in budgeted expenditures by SRA; savings grow to about $2.7 million by FY 2022. The bulk of the savings accrues to local school boards, but the savings are also shared by community colleges and participating governmental units. No effect on local revenues.

Small Business Effect: None.

Analysis

Bill Summary: The SRPS Board of Trustees must establish criteria for setting the qualifications and compensation of professional investment staff positions that it creates under the authority granted by the bill. The criteria must include:

- consideration of the comparative qualifications and compensation of employees serving in similar positions and discharging similar duties at comparable public pension funds;
- limitations on the amount by which the compensation for a position may be increased each fiscal year; and
- objective benchmarks of investment performance that must be met or exceeded by an individual to be eligible for an increase in compensation.

The cost of any new positions created under the authority given by the bill, including fringe benefits, must be funded from existing funds subject to the existing cap on expenditures for investment management services. The board must include expenses for professional investment personnel hired under the bill in the calculation of the fee cap. By October 1 of each year, the board must provide specified committees of the General Assembly with a copy of the criteria. The bill also expands reporting requirements related to compensation for Investment Division staff to reflect these changes.

Current Law: The Investment Division of SRA is established in statute, with the Chief Investment Officer (CIO) serving as head of the division. The SRPS Board of Trustees, on the recommendation of the Executive Director, determines the qualifications and appointment, as well as the compensation and leave, for the CIO. The board may also award financial incentives to the CIO under specified conditions.

The board may also determine the qualifications and compensation for the deputy CIO and managing directors, subject to statutory restrictions. Specifically, the board may **not** (1) set or increase the salary for the deputy CIO at an amount greater than the maximum salary under the ES11 scale of the State's Executive Pay Plan (EPP); (2) set or increase the salary for a managing director at an amount higher than the maximum salary under the ES9 scale of the EPP; (3) provide bonuses to the deputy CIO or managing directors; or (4) increase salaries by more than a specified amount. The board must report annually to the General Assembly on the compensation paid to the deputy CIO and managing directors and other related matters.

Approval of new positions within the Investment Division (and the entire agency) is subject to standard personnel and budget policies and processes, including the approval of the Secretary of Budget and Management and the General Assembly.

The board's administrative and operational costs may not exceed 0.22% of the payroll of SRPS members. Professional investment staff in the Investment Division are regular budgeted positions; their compensation is included in the agency's budget and subject to the State budget process and the 0.22% cap. Investment management fees paid to external managers of the systems assets are nonbudgeted, but they are partially subject to a different cap. Investment management fees paid to external managers of assets other than real estate or alternative investments may not exceed 0.5% of the assets under management in the affected asset classes.

Chapter 397 of 2011 (the Budget Reconciliation and Financing Act of 2011) required that SRA's administrative expenses be paid through a per member administrative fee charged against all participating employers. Each employer, including the State, pays the fee based on its proportion of the total employees who participate in SRPS; the State pays the fee on behalf of libraries.

Background: SRPS relies entirely on external asset managers to manage its investment portfolio; Investment Division staff generally perform an oversight function. In fiscal 2016, investment management fees paid by SRPS to external managers in asset classes that are not real estate or alternative investments were 0.25% of total assets under management in those classes, below the 0.5% cap established in statute.

During the 2016 interim, the SRPS Board of Trustees asked the Joint Committee on Pensions (JCP) to sponsor legislation giving the board the authority to set compensation levels for staff, create and eliminate positions, and approve investment-related expenditures to preserve and enhance the value of SRPS assets. JCP decided to hold the requested legislation and asked staff to work with SRA to explore possible limitations and reporting requirements related to the requested legislation.

The Investment Division currently consists of 22 professional positions, including the CIO, deputy CIO, 4 managing directors, and additional analytical and compliance staff. As noted above, the board is authorized to establish compensation for only 6 of those positions, and compensation for 5 of them is subject to statutory limitations.

State Expenditures: Both budgeted and nonbudgeted expenses for SRPS are paid from the respective expense accounts of the several systems, but the sources of funds are different for the two categories. Budgeted expenditures are paid with money appropriated to the expense account from the per member administrative fees paid by participating employers. Nonbudgeted expenditures are transferred directly from the accumulation fund (*i.e.*, the "trust fund") to the expense fund. Based on fiscal 2016 fee payments, nonbudgeted expenditures can grow by approximately $70.5 million before they reach the capped amount.

State Retirement Agency

The Governor's proposed fiscal 2018 budget includes $8.8 million for the Investment Division, of which approximately $3.6 million is for staff compensation (salary and benefits). Therefore, special and reimbursable fund expenditures by SRA decrease by an estimated $3.6 million, which reflects the bill's July 1, 2017 effective date, due to all personnel costs for the Investment Division being shifted to nonbudgeted status. Out-year savings assume normal growth in salary and benefits for existing staff (*i.e.*, 3.5% annual salary increases and increases in fringe benefits). Nonbudgeted expenditures for SRA in fiscal 2018 increase by a commensurate amount. However, any *additional* increase in compensation for current Investment Division staff beyond normal growth assumed above in the out-years is not included in the estimate. Given compensation levels for comparable staff in other public pension plans, expenditures likely grow by at least 10%.

Based on the SRPS Board of Trustee's testimony to JCP, it anticipates roughly doubling the size of its current staff with the authority granted by the bill, in part to enhance its oversight of existing managers, but also to potentially add an internal management component to its asset management strategy. Assuming those new positions are filled by October 1, 2017, nonbudgeted expenditures increase by an additional $2.3 million in fiscal 2018 and by approximately $3.0 million annually in the out-years. Any delay in establishing or filling those positions delays the fiscal effect. To the extent that the use of internal management reduces nonbudgeted management fees paid to external managers, the increase in nonbudgeted expenditures to pay for new internal management staff may be partially or fully offset.

Pension Liabilities

As noted above, nonbudgeted expenditures by SRA are paid directly from the accumulation fund, which reduces assets available for benefits. Therefore, State pension liabilities increase commensurate with the compensation paid to Investment Division staff. Initially, the increase in liabilities is amortized and paid over time, but ultimately the liability grows to the total amount of the increase due to ongoing compensation payments being made to Investment Division staff on an annual basis.

Administrative Fees

The $3.6 million reduction in the agency's budgeted expenditures translates into a reduction in the State's payment of administrative fees for SRA's administrative and operating expenses. The State pays roughly one-third of those expenses, with local school boards and other local entities paying the rest. Therefore, State expenditures decrease by an estimated $1.2 million in fiscal 2018; as those are personnel costs, they are assumed to be allocated 60% general funds, 20% special funds, and 20% federal and other funds. Out-year savings reflect the State's one-third share of SRA's administrative costs, reaching $1.4 million in fiscal 2022.

Local Expenditures: Expenditures for local school boards, community colleges, and participating governmental units decrease by about $2.4 million in fiscal 2018, reaching about $2.7 million in fiscal 2022, due to a decrease in administrative fee payments. The bulk of the savings accrues to local school boards as they employ a substantial majority of SRPS members who are local government employees.

Additional Information

Prior Introductions: None.

Cross File: HB 1580 (Delegate B. Barnes) - Rules and Executive Nominations.

Information Source(s): Department of Budget and Management; State Retirement Agency; Department of Legislative Services

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