

Department of Legislative Services  
Maryland General Assembly  
2023 Session

FISCAL AND POLICY NOTE  
First Reader

Senate Bill 958 (Senators Benson and Muse)  
Budget and Taxation

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State Retirement and Pension System - Investment Committee - Use of Minority  
Business Enterprises

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This bill requires the Board of Trustees of the State Retirement and Pension System (SRPS) to direct the Investment Committee to use minority business enterprises (MBEs) for (1) at least 20% of brokerage and investment management services and (2) management of at least 20% of the system's assets. **The bill takes effect July 1, 2023.**

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Fiscal Summary

**State Effect:** Nonbudgeted expenditures by the State Retirement Agency (SRA) increase in FY 2024 for transaction costs. State pension liabilities and pension contributions (all funds) increase beginning in FY 2026 due to a decrease in pension system assets; any additional future effect on State pension liabilities and contributions cannot be reliably estimated because it depends on the future performance of invested assets.

**Local Effect:** Similar to the State effect, local pension contributions increase beginning in FY 2026 due to the decrease in pension system assets. Any additional effect on local pension liabilities and contributions cannot be reliably estimated because it depends on the future performance of invested assets. No effect on revenues.

**Small Business Effect:** Meaningful.

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Analysis

**Current Law:** Consistent with minority business purchasing standards in State law and consistent with its fiduciary duties, the board must direct the Investment Committee to *attempt to use, to the greatest extent feasible*, MBEs to provide brokerage and investment

management services. To achieve this goal, the Investment Committee must take measures to remove barriers to the full participation of MBEs in brokerage and investment management services. Current law does not establish a specific numeric goal for MBE participation in brokerage or investment management services.

Chapter 641 of 2022 required the Maryland Department of Transportation (MDOT) and the Governor's Office of Small, Minority, and Women Business Affairs (GOSBA), in consultation with specified entities, to conduct a study regarding brokerage and investment management services used by SRPS to evaluate whether remedial measures to assist minority- and women-owned businesses in those sectors are consistent with specified federal or constitutional requirements. The study must be completed by July 1, 2023. Beginning in fiscal 2023 and annually thereafter, the SRPS board must assess the use of MBEs.

The State's MBE program requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the GOSBA, in consultation with the Secretary of Transportation and the Attorney General. In August 2013, GOSBA announced a new statewide goal of 29% MBE participation that applied to fiscal 2014 and 2015; as no new goal has been established, the 29% goal remains in effect for fiscal 2022. MBEs include women-owned businesses regardless of race.

### *Fiduciary Duties*

Members of the SRPS board, as fiduciaries, must discharge their duties solely in the interest of participants and:

- for the exclusive purpose of providing benefits to members and for reasonable expenses of operating the system;
- with the care, skill, prudence, and diligence under the circumstance then prevailing, that a prudent person acting in like capacity and familiar with such matters would use;
- by diversifying the investments to minimize the risk of large losses; and
- in accordance with the laws, documents, and instruments governing the system.

### **State Fiscal Effect:**

#### *State Retirement and Pension System – System Assets and Liabilities*

The Terra Maria program is the SRPS board's emerging manager program, with the vast majority of its investments being managed by minority- and women-owned investment

management firms. As of June 2022, the program's assets totaled \$2.2 billion, or 3.4% of the system's \$67.9 billion in assets. However, SRA advises that 17.2% of the system's total assets are managed by MBEs, including managers who are not part of the Terra Maria program.

As the current level of MBE asset management is below the bill's 20% goal, the system likely has to liquidate current holdings and transfer them to MBEs to comply with the bill's requirements. As a result, the system likely incurs significant transaction fees to carry out the bill's requirements. A reliable estimate is not feasible as it depends on the timing of the liquidation and the types of assets that are liquidated, but SRA advises that the fees likely total several million dollars. Asset management fees are nonbudgeted.

An increase in fees of that magnitude decreases SRPS assets, thereby increasing its unfunded liabilities. The decrease in assets is first recognized in the fiscal 2024 actuarial valuation, which determines State contribution rates for fiscal 2026. Therefore, State pension contributions (all funds) likely increase beginning in fiscal 2026, although a reliable estimate is not feasible.

Future investment returns by MBE asset managers selected by SRPS relative to asset class or plan benchmarks, or to returns of current asset managers, cannot be reliably predicted, so the bill's long-term effect on system assets (and, hence, unfunded liabilities) cannot be determined. Any effect may be mitigated to the extent the board determines its fiduciary duties preclude implementation of the bill, as specified in current law.

SRA advises that the bill's requirement relative to brokerage services has no practical effect on SRPS operations or assets.

### *Disparity Study*

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.* that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting. MDOT has historically managed the contract for the disparity study. In accordance with Chapter 641, MDOT is including an analysis of investment management and brokerage services by SRPS in the disparity study scheduled to be completed this year. Therefore, the bill does not require additional expenditures to complete a disparity study.

**Local Expenditures:** Any decrease in assets, as discussed above, is first recognized in the fiscal 2024 actuarial valuation, which determines participating governmental unit (PGU) contribution rates for fiscal 2026. Therefore, PGU pension contributions likely increase beginning in fiscal 2026, although a reliable estimate is not feasible.

**Small Business Effect:** Small, minority- and women-owned businesses that provide asset management and brokerage services benefit from a significant increase in business opportunities with SRPS.

**Additional Comments:** *Crososn's* requirement that a program be narrowly tailored has generally been interpreted by the courts to mean that strict race-based quotas for State and local procurements are not allowed. For this reason, current law related to both the MBE program and SRPS's use of MBEs is framed in terms of goals rather than requirements and, in the latter case, includes qualifying language (which is repealed by the bill) that SRPS must *attempt to use MBEs to the greatest extent feasible*. A strict requirement such as the one in the bill may be found to be in violation of constitutional requirements and limitations for race-based preference programs. Further, if the bill's 20% requirement exceeds the availability and utilization of MBEs in brokerage and asset management services found by the disparity study, it may not withstand legal scrutiny.

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### Additional Information

**Prior Introductions:** Similar legislation has been introduced within the last three years. See SB 954 of 2022.

**Designated Cross File:** None.

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

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