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## FISCAL IMPACT REPORT

SPONSOR Zanetti ORIGINAL DATE 1/24/08  
LAST UPDATED \_\_\_\_\_ HB 413  
SHORT TITLE Prohibit State Investment in Hedge Funds SB \_\_\_\_\_  
ANALYST Francis

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY08	FY09	FY10		
	* See narrative			

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB150

### SOURCES OF INFORMATION

LFC Files

Responses Received From  
State Investment Council

### SUMMARY

#### Synopsis of Bill

House Bill 413 would prohibit the investment of state investment council managed assets in a hedge fund. "Hedge fund" is defined as a private investment fund or pool, including a relative value fund, market neutral fund, arbitrage fund, or long or short equity fund, the assets of which are managed by a professional management firm that trades or invests through public or private markets in securities, commodities, currency, derivatives or similar classes of financial assets or is not an investment company pursuant to the 15 U.S.C. 80a-3(c)(1) and 15 U.S.C. 80a-3(c)(7) (defined below).

The prohibition would take effect on July 1, 2008.

### FISCAL IMPLICATIONS

The fiscal implications are significant but difficult to calculate. As of 12/31/07, the SIC had total assets under management of \$16.1 billion, including \$1.48 billion in its "Absolute Return" asset pool. The Absolute Return pool is the asset class that includes hedge funds and makes up 9.2 percent of the portfolio. This asset class returned 8.5 percent in calendar year 2007,

outperforming a benchmark of the 90-day US Treasury Bill plus 200 basis points which returned 7.3 percent. Over the year, SIC earned \$17.8 million more by investing in hedge funds. In November, 2007, the SIC approved a change to the policy target for this asset class from 10 percent to 15 percent.

### **SIGNIFICANT ISSUES**

According to SIC, the SIC's hedge fund investments primarily focus on an absolute return and low volatility strategy overall, intended to neutralize market risk, and produce positive returns in most market environments. Risk is mitigated via diversification among 13 managers which have exposures to more than 400 individual hedge funds employing various styles and strategies. The benchmark for this asset class is pegged at a conservative return goal of T-bills plus 200 basis points. Put simply, the SIC's hedge funds are meant to help diversify the Fund, provide protection during down markets, and achieve returns above what has been an increasingly challenging investment environment in the fixed income arena.

### **PERFORMANCE IMPLICATIONS**

All of the funds were allowed to diversify when the "legal list," a statutory list of allowed investments was repealed and replaced with the broader "Prudent Investor" rule which allows SIC, the Public Employee Retirement Association (PERA), and the Education Retirement Board (ERB) to invest in a much broader range of investments, including hedge funds, private equity, and real estate [45-7-601 to 45-7-612 NMSA 1978].

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

Relates to SB150 which would add an additional member to the Council.

### **TECHNICAL ISSUES**

HB413 would prohibit future investments but existing investments in hedge funds would not have to be liquidated because the language refers to future decisions not past ones.

According to SIC, HB 413 fails to adequately define hedge fund, as its broad definition of hedge fund could be construed broadly to include private equity funds as well as several other alternative investment vehicles, including real estate partnerships. This imprecision could lead to disruption of ongoing SIC private equity investments, inclusive of those made in New Mexico companies or venture funds.

### **OTHER SUBSTANTIVE ISSUES**

The bill only refers to SIC and hedge fund investments but the PERA and the ERB also invest in hedge funds.

The LFC reports quarterly on the investment performance of all funds by asset class and time period. These reports can be found on the LFC web site at <http://legis.state.nm.us/lcs/lfc/lfcpublications.asp>

**WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

The SIC will continue to invest the state permanent funds according to the Prudent Investor rule.

NF/bb