FISCAL IMPACT REPORT

ORIGINAL DATE 01/31/12

SPONSOR Neville/Keller **LAST UPDATED** **HB**

SHORT TITLE State Investment Council Membership & Duties **SB** 53

ANALYST Hoffmann

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY12	FY13	FY14	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$2.3 to $9.6	$2.3 to $9.6		Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Attorney General's Office (AGO)

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State Investment Council (SIC)

SUMMARY

Synopsis of Bill

Senate Bill 53 (SB53) proposes to amend sections of Chapter 6 Article 8 NMSA 1978, *Investment of Public Money*, to change the composition of the State Investment Council, provide for the election of the chair and vice-chair of the council, the appointment of the State Investment Officer (SIO), and extend the deadline for monthly reporting.

The bill proposes the following specific changes to the structure of the State Investment Council. The following eight member positions would be changed.

- The Secretary of the Department of Finance and Administration would replace the governor.
- The State Treasurer would be replaced by his or her appointee.
- The State Land Commissioner would be replaced by his or her appointee.
- The Chief Financial Officer for a New Mexico institution of higher learning member (appointed by the governor with the advice and consent of the senate) would be eliminated.
- Four member positions appointed by the Legislative Council would be eliminated.

The bill adds ten members to the council.

- One member appointed by the State Treasurer
- One member appointed by the Commissioner of Public Lands
- One member appointed by the president pro tempore of the senate with the advice and consent of the senate
- One public member appointed by the minority floor leader of the senate with the advice and consent of the senate
- One public member appointed by the speaker of the house of representatives with the advice and consent of the senate
- One public member appointed by the minority floor leader of the house of representatives with the advice and consent of the senate
- Four members appointed by the governor with the advice and consent of the senate, but no more than two of these appointments can be of the same political party

Members of the council would serve until their replacements are appointed and have qualified.

The chair and vice-chair of the council would be selected from the appointed members (this excludes the Secretary of the Department of Finance and Administration). The chair and vice-chair would serve staggered two-year terms and may not serve more than two consecutive terms.

The bill would require that the State Investment Officer, appointed by the council, be subject to the advice and consent of the senate.

The schedule for monthly reports from the SIO to the Secretary of the Department of Finance and Administration and to the SIC is extended from ten days after the close of each month to thirty days after the close of the month. These reports would no longer be circulated to a "list of investment bankers and brokers recommended by the council." These reports would be available on the council's web site but no longer on the Department of Finance and Administration's or Legislature's web sites.

FISCAL IMPLICATIONS

The only potential impact of SB53 identified by the SIC is the cost of additional per diem for appointees by the Treasurer and State Land Commissioner. Currently those members do not collect per diem per statute. Public members on the SIC – some who travel hundreds of miles to every monthly meeting are paid for mileage and hotel costs, which can result in up to $400/month in reimbursements. The SIC would anticipate up to 24 additional reimbursements per year, ranging between $95-$400 each, for an overall annual impact on the SIC's budget of $2300-$9600.

<u>Effective Date</u>: The bill would take effect on July 1, 2012.

SIGNIFICANT ISSUES

The following discussion, provided by the SIC, gives useful background information on the problems SB53 seeks to address, along with highlights of progress to date.

The past few years have brought significant change and reform to the State Investment Council itself, as well as the manner in which New Mexico invests its permanent funds.

Legislative efforts to reduce the influence of the Governor on the SIC began in 2008, but did not really get underway until late 2009 with the departure of the former State Investment Officer. This was followed by the Legislative Council & Board of Finance hiring an independent expert (Ennis Knupp) to identify problematic policy & procedural issues at the SIC, ERB and PERA, which helped lead to the passage of SB 18 during the 2010 session.

The legislative reforms changed the fundamental structure of the Council, reducing the powers of the Executive and completely removing the State Investment Officer from the Council itself, while adding 4 appointments from the Legislature to help check and balance political influences that might sway investments or diminish the fiduciary duties of the Council. To date, these changes have proven to be very effective.

Previously the State Investment Council set investment policy and only approved a limited number of specific alternative investments at their public meetings, while the State Investment Officer had ultimate control over the other 90% of the investment decisions. Today, the Council itself requires approval of any contracts greater than $50k, reviews all aspects of the portfolio quarterly if not on a monthly basis, and governs through multiple public Committee and Council meetings every month. Through webcasting and information posting to its website, the Council has also increased its reporting and transparency practices to a level far exceeding investment industry standards.

While the Council has been leading the way in reforming the policies and procedures behind the State's investments, reforms of this nature and size take a considerable amount of time, effort and care to accomplish properly. Moving public assets into more stable, less risky real assets and diversified alternative investment strategies which will produce more consistent revenue is both a priority and a challenge the Council has adopted over the past year, and having Council members who are engaged and committed to this process is important. Council members have taken a great deal of hands-on involvement in SIC investment activities and oversight since the board was reconstituted, as have the new members who have arrived with the new administration.

While changing multiple members of the Council may not derail the ongoing reforms and efforts to reduce volatility, it could require the expenditure of valuable time, effort and resources which could better be focused elsewhere. The examples below serve to illustrate some of the reform work performed recently by the new Council, as well as some of the anticipated needs in the near future:

- In 2011, the Council approved a new asset allocation, targeting reduction of long-term exposure to public stock market volatility, to be replaced with real assets, which should produce steadier income streams and help diversify the portfolio;
- The 11-member Council is now fully appointed, and its Investment, Private Equity, Governance and Audit Committees typically each meet on a monthly basis;
- In October 2011, the Council adopted its Code of Conduct, which dovetails with the Code of Ethics signed annually by all staff;
- The Council modified its annualized investment return target from 8.5% per year to a more-realistic 7.5%, which will help reduce long-term portfolio volatility and risk profile;
- The Council terminated an additional 6 underperforming external investment managers in

2011, for a total of 15 since April 2010;
- The Council has already executed $2.5B of investment management contracts in FY 2012;
- Internal management of SIC investments has been reduced from 40% of assets to 14% in last 18 months; and
- The Council adopted a list of 22 investment-related RFPs, with nine completed so far and the remainder already planned for the next 8 quarters - all will require the intensive participation of one or more Council members during the initial and final vetting phases, which often include dozens of respondents.

These reforms helped contribute to all-time best permanent fund returns of more than +22% for FY 11.

ADMINISTRATIVE IMPLICATIONS

SB53 provides for the orderly transition of the council membership. On the bill's effective date, the governor, State Treasurer, Commissioner of Public Lands, and the chief financial officer appointed by the governor would no longer be members. The governor, State Treasurer, and Commissioner of Public Lands would be required to make their appointments pursuant to the bill within 30 days. These members would serve on an interim basis until confirmed by the senate.

The members appointed by the Legislative Council would serve until their terms expire or they resign or are removed.

TECHNICAL ISSUES

The SIC raises the following concerns.

SB53 does not appear to contemplate if the Treasurer or State Land Commissioner chose to appoint himself to the Council, assuming requisite experience and later approval by the Senate.

The bill's language also does not specifically say the Treasurer and Land Commissioner appointments require "advice and consent of the Senate", though the bill makes subsequent allusion to this being the expected practice.

The bill also requires the State Treasurer and State Land Commissioner appointments to serve 5-year terms, which would seem to run in slight misalignment to the 4-year-election cycle associated with those publicly elected offices. It is unclear if that is the intent through design, or to simply be equitable with other SIC public member seat terms. The bill also states that the STO and SLO appointments, like the public members, be 'staggered'. While this is would be ideal in practice to maintain a greater level of consistency of the board as a whole over time, how to stagger those two appointments is not defined in the bills temporary transition provisions.

CH/lj