F I S C A L   I M P A C T   R E P O R T

SPONSOR SFC **ORIGINAL DATE** 3/17/15
LAST UPDATED **HB**

SHORT TITLE State Investment Changes **SB** 174/SFCs

ANALYST van Moorsel

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	FY16	FY17	FY18	FY19		
Indeterminate - See "Fiscal Implications"						

(Parenthesis ( ) indicate revenue decreases

Relates to House Bill 28 - Small Business Development Fund Act

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)

SUMMARY

Synopsis of SJC Amendment

The Senate Judiciary Committee amendment clarifies that the Legislature must appropriate the SIC's operating budget each year.

Synopsis of SRC Amendment

The Senate Rules Committee Amendment strikes the requirement that members of committees formed to inform council investment decisions and firms hired by the SIC disclose political contributions to council members.

Synopsis of Original Bill

Senate Bill 174 amends the statute governing the investment of public money to make administrative changes affecting the SIC and the State Investment Office (SIO) including:

- Providing indemnification for Council Members and staff. SIC notes the provision is

modeled on indemnification already provided to ERB and PERA board members, except it also includes a clawback provision, similar to that found in the Tort Claims Act, whereby the state can recover money paid on behalf of person acting fraudulently or with malice;
- Eliminating the Private Equity Investment Advisory Committee (responsibilities will be assumed by Council Investment Committee);
- Permitting the SIC to delegate investment-related functions to the State Investment Officer;
- Requiring disclosure by members of committees formed to inform council investment decisions and firms hired by the SIC of political contributions to council members;
- Amending qualifications of Council Members to require ten years' experience in the field of investment management, investment risk management, corporate governance, investment accounting, or finance.
- Amending the required qualification of the State Investment Officer to include at least 10 years of investment and executive experience; and providing the state investment officer serves at the will of the SIC;
- Require the appointment of a Deputy State Investment Officer who must have seven years' professional experience in institutional investment management;
- Reducing number of required annual meetings from 12 to 10; and
- Revising monthly reporting requirements to require monthly reporting 20 (rather than 10) days after the end of each month and reduce the information the reports must contain.

The bill makes further changes, identified by SIC as being less-substantive, including:

- Clarifying that all SIO employees are covered by the bond protecting the state's interest;
- Clarifying that the SIC supervises investment activities of the SIO;
- Authorizing the appointment of investment management and consulting firms and adding the disclosure requirement described above;
- Authorizing the Council's use of committees and adding a substantive disclosure requirement for committee members;
- Providing that SIO staff, outside managers, and consultants are fiduciaries;
- Including investment office staff (with the State investment Officer) among those that are exempt who are exempt from the New Mexico Uniform Securities act in performing investment services for a state agency;
- Clarifying that authority resides with the SIC and the SIO to contract to invest money for private endowments created solely to benefit public school students;
- Because *ex officio* SIC members are designated to serve by virtue of their office, the bill clarifies that *ex officio* SIC members are not precluded from acting in an "active or advisory capacity" concerning the investment of the permanent funds.

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends.

FISCAL IMPLICATIONS

The SIC states that although it can quantify neither costs nor gains, the council expects the substantive changes proposed in SB 174 to increase the efficacy of the SIC and SIO. As such, the SIC expects the bill would have a positive fiscal impact, adding that as it invests funds worth over $20 billion, even small improvements can have significant fiscal implications.

The SIC analysis of SB174 reports the substantive changes are expected to improve returns by:

- helping the SIC and SIO to continue to attract and retain the most qualified people to manage the permanent funds;
- preventing political corruption that detrimentally affected past investment decisions; and
- allowing SIC members staff to more efficiently invest funds.

Although the new indemnification provision may have some theoretical negative fiscal implications because it allows for indemnification from the permanent funds, SIC staff anticipate it will not have any fiscal impact for two primary reasons:

- only a limited number of circumstances that the State is not already obligated to cover under the Tort Claims Act are implicated by the indemnification provision; and
- in the multiple years since the SIC was reconstituted, SIC staff is not aware of incidents occurring for which liability might arise under the new provision.

Finally, the clawback provision would mean that the state will get back any money paid on behalf of any person acting with malice or intent to defraud.

SIGNIFICANT ISSUES

SIC states the new indemnification provision was drafted to match the indemnification provision applicable to ERB and PERA with one significant difference, the proposed indemnification includes a clawback power.

According to SIC's analysis, eliminating the Private Equity Investment Advisory Committee (PEIAC) is intended to allow the SIC and SIO to use a more efficient investment procedure. Currently, PEIAC reviews investments in private equity and the Council Investment Committee (CIC) reviews all other investments. SIC argues the CIC should review all investments, so as to have 100 percent advisory oversight in making uniform investment recommendations to the full council.

SIC adds the amendment to the reporting requirement would replace what is currently a meaningless and unwieldy monthly transaction report consisting of several hundred pages regarding external manager transactions (SIC assets are today 100 percent externally managed) for a monthly statement that would provide all relevant information to assist those seeking to review SIC funds.

OTHER SUBSTANTIVE ISSUES

As SIC reports, the conclusions reached by Hewitt-Ennis Knupp following their fiduciary review of the SIC following its pay-to-play scandal in 2009 resulted in several conclusions, including that inexperienced and/or unqualified people led to inadequate policies, procedures and governance practices which allowed unscrupulous individuals to take advantage of the state and its invested billions. Significant losses to the SIC portfolio, as well as improper payments to placement agents, clearly centered around complex strategies being overseen by individual portfolio managers who lacked significant financial experience, and/or were not subject to appropriate levels of SIC oversight and transactional approval. SIC states resulting losses are indeterminate, but can conservatively be estimated in the tens of millions of dollars.

The SIC argues that having SIC members with extensive experience, high levels of board engagement, and strong belief in their fiduciary responsibilities is similarly critical to proper oversight and management of the state's permanent endowment. Attracting the best, brightest and most honorable to unpaid volunteer positions as SIC members could potentially be problematic in the future, should these individuals also face personal or financial burdens and exposures associated with nuisance lawsuits or similar legal liabilities determined to not be covered by the tort claims act or indemnified by the state.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

PvM/aml/bb/je/aml