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

SPONSOR Munoz
ORIGINAL DATE 02/16/17
LAST UPDATED 03/07/17
HB

SHORT TITLE Investment Pool Charges To State Treasure
SB 382/aSFl#1

ANALYST Clark

APPROPRIATION (dollars in thousands)

Appropriation					Recurring or Nonrecurring	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
	$178.0	$178.0	$178.0	$178.0	Recurring	State Treasurer's Office

Parenthesis ( ) indicate expenditure decreases

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY17	**FY18**	**FY19**	**FY20**	**FY21**		
	($178.0)	($178.0)	($178.0)	($178.0)	Recurring	General Fund

Parenthesis ( ) indicate revenue decreases

Relates to HB251
Relates to Appropriation in the General Appropriation Act

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Treasurer's Office (STO)

SUMMARY

Synopsis of Senate Floor Amendment #1

The Senate Floor amendment strikes the non-reverting language in the original bill, leaving excess management fees to revert to the general fund. However, the amendment also now provides for continuing appropriations of the management fees to the State Treasurer's Office, thereby increasing the operating budget and reducing general fund revenues due to the reduction in, or loss of, reversions.

<u>Synopsis of Original Bill</u>

Senate Bill 382 expands the authorized expenditure by the State Treasurer's Office (STO) of management fees that it collects from the local government investment pool (LGIP) to include operations of STO. Additionally, any remaining balance at year end would not revert. However, the current statutory requirement for expenditure of these funds to be subject to legislative appropriation remains.

The effective date of this bill is July 1, 2018.

FISCAL IMPLICATIONS

Approximately $300 thousand in management fees for administration of the LGIP are received by STO annually. The Legislature appropriates $122.3 thousand of these funds to STO for the prescribed uses, and the remainder reverts to the general fund. By preventing the reversion, this bill creates a negative general fund impact. However, unless the Legislature chooses to increase the annual appropriation of these funds, the remainder will stay in the STO operating account but be unavailable for use.

SIGNIFICANT ISSUES

Due to budget cuts, STO has been unable to hire a chief investment officer and a financial chief risk officer, and the agency reports both positions are critical to the safety and security of the various funds managed by STO.

STO manages approximately $661 million in LGIP funds. STO charges a 0.05 percent management fee to help cover the costs that the agency incurs in managing the LGIP. These fees fluctuate depending on how much is in the LGIP, but on average total $300 thousand annually. Currently, the Legislature allows STO to retain a portion of the fees ($122.3 thousand), and the balance is credited to the general fund.

STO provided the following analysis.

> The amount appropriated to STO to cover administration of the LGIP has not been increased in a number of years, yet STO has managed this portfolio without incident. The risks that must be managed, however, are ever-increasing and include, but are not limited to, interest rate risk, cyber security risk, credit risk, operation risk, fraud risk and liquidity risk, as well as the ability to hire competent, experienced portfolio managers who oversee the funds.
>
> The costs to oversee the fund have also risen. These additional costs or expenses include, but are not limited to the following:
>
> - portfolio management, transaction settlement and administrative staffing
> - rating agency fees
> - Bloomberg trading platform costs
> - annual audit and investment accounting costs
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> Currently STO is working with the Department of Finance and Administration (DFA) and Deloitte to create investing accounting capabilities through SHARE. However, the

project is still in the development stage and may not be ready and operational for several months or a year. Once this investing program is complete, STO will have to run dual systems until all the bugs are worked out and the system is reliable. This could take several years before STO could see a cost savings on in-house investment accounting capabilities.

RELATIONSHIP

This bill relates to the appropriation to STO in the General Appropriation Act and to HB251, which clarifies that the Educational Retirement Board, the Public Employees Retirement Association, and the State Investment Council may participate in the LGIP.

TECHNICAL ISSUES

It appears the intent of the bill may have been to appropriate the entirety of the management fees to STO for the prescribed uses, but by retaining the language "subject to appropriation by the legislature," any funds in excess of the annual appropriation will not be available for use.

OTHER SUBSTANTIVE ISSUES

The priorities for STO's investment strategies are: 1) safety of the principal, 2) maintenance of liquidity, and 3) maximum return on investments. During FY16, as general fund revenues fell far below initial projections and dipped below appropriations, general fund balances held by STO declined significantly.

STO has the responsibility to ensure the state's solvency and shares authority with DFA to halt warrant redemption if revenues appear unable to meet spending levels given the best available information. LFC's monthly revenue reports noted late in FY16 the state appeared to be on track to fall well below revenue estimates and appropriation levels. Neither DFA nor STO halted warrant redemption, and the state ended FY16 insolvent with a deficit in available general fund reserves. This necessitated a special legislative session to address the solvency issue retroactively.

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

JC/al