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FISCAL IMPACT REPORT

ORIGINAL DATE 02/15/10

SPONSOR HFI LAST UPDATED _____ HB CS/289/HFIS

SHORT TITLE Change Investment Council Membership SB _____

ANALYST White

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY10	FY11	FY12	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	\$0.1	\$0.1	\$0.1	\$0.1	Recurring	SIC Operating Fund

(Parenthesis () Indicate Expenditure Decreases)
Conflicts and Duplicates with SB 18

SOURCES OF INFORMATION

LFC Files

Responses Received From
State Investment Council (SIC)

SUMMARY

Synopsis of HFI Substitute

The House Floor Substitute for House Bill 289 changes the make-up of the State Investment Council (SIC) by increasing the number of members from 9 to 11 while simultaneously decreasing the number of Governor's appointees who serve on the council. The bill would accomplish this by:

- eliminating three public members appointed by the governor with the advice and consent of the Senate;
- eliminating the State Investment Officer (SIO) as a member of the council;
- allowing the Legislative Council to appoint four public members with the advice and consent of the Senate, no more than two of which may be from one political party; and
- adding 2 additional public members appointed by the Governor with the advice and consent of the Senate.

The incoming public members' term length would differ from current statute in order to properly stagger council membership. One new member would serve for a period of one year, one new member for two years, two new members for three years, one for four years, and one new member for five years. After the initial terms have been served term lengths would return to the current statutory level of five years. The six new member's initial terms of service as per the

aforementioned schedule would be determined “by lot.” Furthermore all new public members would be required to have “no less than ten years experience in the field of investment or finance.”

Due to the membership changes, the substitute would also change SIC quorum requirements. Currently 5 of 9 members are required to establish a quorum with at least 3 of the 4 public members being in attendance. If this legislation were enacted, a quorum would require a simple majority of the entire council.

The substitute changes the appointment process of the State Investment Officer (SIO) so that such an appointment is made by the Council itself as opposed to the Governor. The proposed legislation also eliminates language requiring “the advice and consent of the Senate” in the appointment process. The substitute also removes language requiring the SIO to be removed in the same manner as a member of a University Board of Regents, and thus allows the council to remove the SIO at its discretion for cause. The SIC and SIO are also defined as trustees of the fund, and the SIC is given the discretion to delegate responsibility to the SIO.

The proposed legislation would also permit the investment agencies to contract with their own custodial bank. Currently the State Board of Finance (BOF) enters into one contract on behalf of all state investment agencies.

The proposed legislation maintains the Governor as council chair and provides for a vice-chairman of the council, selected by the members of the council. Under current law the council has no vice-chairman. The proposed legislation also explicitly states that the existing public member appointed by the Governor, who is a CFO at a state higher education institution, “shall serve at the pleasure of the Governor.”

The substitute would also change statutory language in order to require council members to act in accordance with the “Governmental Conduct Act” instead of the “Conflict of Interest Act” as currently required. The proposed legislation also prohibits members of the council from doing business with the following governmental entities for periods of two years before and two years after membership.

- The State Investment Office or Council
- The Office of the State Treasurer
- The Educational Retirement Board
- The Public Employees Retirement Association
- The New Mexico Finance Authority
- The State Board of Finance

The HTRC substitute for House Bill 289 also carries an emergency clause.

FISCAL IMPLICATIONS

This legislation would create a minor impact on the SIC operating budget related to additional printing and administrative costs, as well as additional per-diem payments to the increased amount of public members. These additional costs are expected to be minimal.

The substitute may also have additional operating impact on SIC with regard to granting it the ability to RFP and contract with its own custodial bank. The agency’s operating budget is currently not funded with any general fund appropriations, and thus this provision would have no direct general fund impact. Currently the State Board of Finance (BOF) contracts with one

custodial bank on behalf of all state investment agencies. As BOF is currently in the process of awarding a new four-year custodial bank contract, it is unclear if and when these additional operating impacts will occur.

SIGNIFICANT ISSUES

The State Investment Council (SIC) is a non-cabinet level agency that reports directly to the Governor, who chairs the council and appoints the State Investment Officer. SIC has been in existence since 1958 and is charged with administering the state's permanent funds. The two largest permanent funds, the Land Grant (LGPF) and Severance Tax (STPF) Permanent Funds, consisted of more than \$12.5 billion in assets as of December 31, 2009. The council currently consists of:

- Governor Bill Richardson, Chairman
- Acting State Investment Officer Bob Jacksha
- State Treasurer James Lewis
- Commissioner of Public Lands Pat Lyons
- DFA Secretary Katherine Miller
- Public Member David Harris (Appointed as CFO of a State University)
- Public Member Andrew Davis
- Public Member Peter Frank
- Public Member Stephen Feinberg

Recently the state's investments have seen a great deal of turmoil both from a performance standpoint and a reputational standpoint. The HTRC substitute for House Bill 289 addresses some of these issues by proposing a number of different changes to the council's makeup and council member conduct requirements. Some of the proposals in the substitute are also included in an Independent Operating and Fiduciary Review (IOFR) performed by institutional investment advisor Ennis Knupp and Associates on behalf of the Legislative Council and State Board of Finance. However, there are a number of recommendations made in the IOFR which are not included in the proposed legislation.

The substitute changes the governance of the SIC. The IOFR stated with respect to SIC that the Governor's current "amount of influence is greater than that of most other funds," and should be "balanced by including legislative appointees on the Council or increasing the number of ex-officio members who are not part of the executive branch." If the substitute were enacted, the Governor would still appoint more members than any other source and therefore the board would remain arguably unbalanced. Under the proposed legislation the makeup of the SIC would be such that:

- 5 of 11 members will be the Governor and direct Governor appointees,
- 4 of 11 members will be legislative appointees, and
- 2 of 11 members will be ex-officio elected officials.

If the proposed legislation is enacted, the Governor would remain chairman of the council. The IOFR performed by Ennis Knupp reported that national best practices are for council members to independently elect a chairman and vice-chairman from amongst themselves as opposed to having a de-facto chair set in statute. Therefore various provisions in the proposed legislation appear to differ from national best practices and contradict numerous findings in the Ennis Knupp IOFR.

The substitute inserts new language into Subsection C of 6-8-3 NMSA 1978 explicitly stating that the member appointed as the CFO of a New Mexico higher education institution “shall serve at the pleasure of the governor.” It is unclear why such language is either necessary or prudent given the findings of the Ennis Knupp IOFR.

TECHNICAL ISSUES

State Investment Council (SIC):

“HB 289 allows the Council to “...delegate administrative functions to the state investment officer.”

“Day to day operations of the State Investment Office are by no means simply administrative in nature. Investment decisions are made on a weekly, daily or in some cases hourly basis, as market action dictates. The Council may wish to delegate more than administrative functions to the investment officer they choose, assuming proper reporting and oversight measures are in place.”

CONFLICT, DUPLICATION

The HTRC substitute for House Bill 289 conflicts with and duplicates parts of the SFC substitute for Senate Bills 18, 218, and 238, which would also change the governance of the SIC. The SFC substitute also addresses a number of IOFR recommendations not addressed in the HTRC substitute including:

- explicitly defining council/board member fiduciary duty;
- allowing the members of the SIC to independently elect its chair;
- mandating certain attendance requirements on board members; and
- explicitly addressing board member ethical requirements relative to gifts and campaign contributions.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If the HTRC substitute for House Bill 289 or similar legislation is not enacted, the SIC could continue to statutorily operate well outside the realm of national best practices. This has the potential to create the risk that further turmoil and suspicion, from both a performance and reputational perspective, will continue to accompany the SIC at the potential cost of hundreds of millions of taxpayer dollars.

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