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

SPONSOR Neville

ORIGINAL DATE 02/03/10
LAST UPDATED 02/04/10

HB

SHORT TITLE Change Investment Council Membership

SB 218

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 and SB 238

SOURCES OF INFORMATION
LFC Files

Responses Received From
Attorney General's Office (AGO)
State Investment Council (SIC)
Higher Education Department (HED)

SUMMARY

Synopsis of Bill

Senate Bill 218 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 President Pro Tempore of the Senate, the Minority Floor Leader of the Senate, the Speaker of the House of Representatives, and the Minority Floor Leader of the House of Representatives to each appoint a public member to the council, and
- adding 2 additional public members nominated by the Governor and elected by the majority of the other 9 SIC members 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, Senate Bill 218 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 proposed legislation maintains the Governor as council chair and further 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."

Senate Bill 218 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

Senate Bill 218 would also amend the appointment process for the SIO, by granting such appointment power to the members of the SIC with the advice and consent of the Senate. Currently the Governor has sole authority to appoint the SIO with the advice and consent of the Senate.

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.

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. Senate Bill 218 addresses some of these issues by proposing a number of different changes to the ways in which investments are made including board makeup, decision making processes, and board member conduct. Some of the proposals in Senate Bill 218 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. There are a number of recommendations made in the IOFR which are not included in Senate Bill 218, but the proposed legislation does address some of what were considered to be the review's more vital points. These points include board composition, board member conduct and influence, and the methodology and procedure for appointing the SIO.

Senate Bill 218 makes a number of substantial changes to 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." The proposed legislation addresses this problem by changing the makeup of the SIC so that:

- 5 of 12 members will be the Governor and direct Governor appointees,
- 4 of 12 members will be legislative appointees,
- 2 of 12 members will be ex-officio elected officials independent of both the executive and legislative branches.

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 the council members to independently elect a chairman and vice-chairman from amongst themselves as opposed to having a de-facto chairman set in statute. Senate Bill 218 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 review.

State Investment Council (SIC):

> "Additional oversight and direction of the state's permanent fund investments has the potential to improve policies, procedures and execution of the day to day operations of the Investment Office, and as a result may improve investment performance in the long

run, although some transition pains should be expected. SB 218 offers significant changes to the Council's structure and the Investment Office's operations, but these changes would not be as drastic or disruptive to central investment making abilities of the Office as some legislation that has been suggested in the past.

It should be noted that additional oversight, just like any other added regulation or control, comes at the potential cost of reduced flexibility on the part of the state Investment Office. This could translate into loss of investment agility, increased reaction time, and a lessening of ability to quickly react to market changes under rapidly changing market conditions. It may be challenging to strike a balance between overregulation and an agency that lacks the transparency necessary for effective board and legislative oversight. However, finding middle ground between the two will ultimately produce the greatest returns for the Permanent Funds."

ADMINISTRATIVE IMPLICATIONS

State Investment Council (SIC):

It should be noted that the Council, by statute, must meet monthly – or at minimum 12 times per year. Members who call-in are currently considered to be in attendance and able to vote, though the Attorney General's office has indicated it may revisit that issue due to it becoming more commonplace for members to call in, rather than an emergency situation preventing direct attendance. Ennis Knupp's review suggested an "in-person" attendance requirement of at least 80% for members would be best-practice. Council members are not allowed to send a designee to vote for them. SB 218 does not address the Ennis Knupp recommendation regarding attendance, or specific removal for failure to attend.

It is notable that finding and appointing 6 new SIC public members who are qualified and without conflict, and are willing to commit significant time and personal liability to an unpaid public service position poses a potentially significant challenge, especially given the current litigious environment and scrutiny regarding all Council issues.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 218 conflicts and or duplicates with parts of Senate Bills 18 and 238, which also propose governance changes at the SIC.

TECHNICAL ISSUES

The proposed legislation strikes language in Subsection B of 6-8-3 NMSA 1978 which states:

> "During tenure, a member of the council shall not be engaged in any capacity in the sale of securities to the state."

The bill then inserts language prohibiting members from having business contracts with various investment related state agencies and a quasi-governmental agency for two years prior to appointment and two years after their service has ended. The inserted language does not prohibit members from having business contracts while he or she is a member. The proposed legislation may need to be amended to address this issue.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If Senate Bill 218 or similar legislation is not enacted, the SIC could continue to statutorily operate 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.

DMW/svb