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

SPONSOR McSorley

ORIGINAL DATE 02/04/10
LAST UPDATED
HB

SHORT TITLE State Investment Changes

SB 238

ANALYST White

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY10	FY11	FY12	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	$0.0	$0.0	$0.0	$0.0	Recurring*	SIC Operating Fund
	$0.0	$0.0	$0.0	$0.0	Recurring*	ERB Operating Fund
	$0.0	$0.0	$0.0	$0.0	Recurring*	PERA Operating Fund

(Parenthesis ( ) Indicate Expenditure Decreases)
* See Narrative

Relates to and Conflicts with SB 18 and SB 218

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
Educational Retirement Board (ERB)
Attorney General's Office (AGO)
Public Employees Retirement Association (PERA)

Responses Not Received From
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

Senate Bill 238 makes changes to the duties and powers of the State Investment Council (SIC), Educational Retirement Board (ERB), and Public Employees Retirement Association (PERA) by explicitly assigning fiduciary responsibilities and allowing each agency to contract with their own custodial bank.

Senate Bill 208 also decreases the membership of the SIC by eliminating the Governor as ex-officio chairman of the Council. As a result, the 8 remaining members of the SIC will elect a chair and vice-chair from amongst themselves. The proposed legislation also mandates that all members of the council as well as officers and employees will be subject to the Governmental Conduct Act as opposed to the Conflict of Interest Act.

FISCAL IMPLICATIONS

The proposed legislation carries no direct general fund fiscal impact. However, it will create a minor additional operating impact on SIC, ERB, and PERA as they would now most likely choose to RFP and contract with their own custodial bank. None of these three agencies' operating budgets are funded with general fund appropriations. 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

Recently the state's investments have seen a great deal of turmoil both from a performance standpoint and a reputational standpoint. Senate Bill 238 attempts to address some of these issues by proposing a number of different changes to the ways in which state investments are made including board makeup, board member conduct, and board member responsibility. A majority of the proposals in Senate Bill 238 are also included in the recommendations of 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. These recommendations include:

- allowing the SIC to elect their own chair and vice-chair,
- allowing SIC, ERB, and PERA to contract with their own custodial bank, and
- explicitly assigning fiduciary responsibility to board/council members, contracted advisors, and any "other persons exercising discretionary authority or control of funds under management."

Senate Bill 238 also removes the Governor from the SIC. This provision would appear to be an attempt to address an additional IOFR recommendation. 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." While removal as a member would undoubtedly decrease executive influence over the SIC, 6 of the 8 remaining council members would still be directly or indirectly appointed by the Governor.

There are a number of recommendations made in the IOFR which are not included in Senate Bill 238. Many of these other recommendations, which mostly pertain to SIC, are included in other proposed pieces of legislation currently before the Legislature including:

- removing the State Investment Officer (SIO) from the SIC,
- removing the power of appointing the SIO from the Governor and placing it in the hands of the full SIC,
- reclassifying all SIC Governor exempt employees thus giving the power to hire and fire to the SIO, and

- implementing mandatory attendance requirements for members of SIC, ERB, and PERA.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 238 conflicts and or duplicates with parts of Senate Bills 18 and 218, which also propose various statutory changes related to state investment agencies.

TECHNICAL ISSUES

State Investment Council (SIC):

Under SB 238, it would take five out of eight Council members to approve an investment, policy or similar action. There is not specific guidance defined under this bill as to what would happen under a 4-4 tie vote of the Council.

SB 238 leaves the existing double quorum requirements for the Council, requiring 5 of 8 members be present, as well as 3 of 4 public members. Historically this has been challenging at times due to the busy schedules of the SIC members. This has not been the case in the past several months, due to the obvious increase in the engagement and attention of all of its members across all aspects of SIC and SIO activity.

Elimination of such a double quorum requirement was also mentioned in the IOFR recommendations from Ennis Knupp.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

If Senate Bill 238 or similar legislation is not enacted, the SIC, PERA, and ERB 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 state investment process at the potential cost of hundreds of millions of taxpayer and retiree dollars.

DMW/mew