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

SPONSOR Heaton **DATE TYPED** 02/07/05 **HB** 55/aHEC

SHORT TITLE Educational Retirement Fund Investments **SB**

ANALYST Geisler

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	**FY06**			
	$8,000	$30,000 (FY07); $55,000 (FY08), $83,000 (FY09)	Recurring	Educational Retirement Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to: SB 60

SOURCES OF INFORMATION

LFC Files
Educational Retirement Board (ERB)
Public Employees Retirement Association (PERA)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of HEC Amendments

The House Education Committee made technical changes to the bill to amplify that investments are to be made in accordance with the Uniform Prudent Investor Act. Also the board shall provide quarterly performance reports to the legislative finance committee and department of finance and administration. Annually, the board shall ratify and provide its written investment policy, including any amendments, to the legislative finance committee and department of finance and administration.

Synopsis of Original Bill

House Bill 55 would eliminate the Educational Retirement Board’s (ERB) current “legal list” of permissible investments and replace it with the guiding principles of the Uniform Prudent Investor Act (“UPIA”). The UPIA sets a higher standard of care for a fiduciary or trustee, above and beyond the current standard and guiding principles in law. The UPIA requires fiduciaries or trustees to take into account the condition of the entire trust and other modern economic factors in making investment decisions instead of individual assets as the old standard and "legal lists" dictates.

Under the UPIA, trustees shall invest and manage the trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. To satisfy this higher standard, trustees shall exercise reasonable care, skill, and caution. As a result of the standard of care, trustees' investment and management decisions respecting individual assets must be evaluated in the context of the trust as a whole and part of an overall investment strategy with specific risk and reward objectives identified by the trust.

Significant Issues

- The UPIA holds the ERB trustees to a higher standard by requiring investment decisions to be made prudently and be supported by expertise with the sole interest of the beneficiaries in mind.

- The higher standard of prudence applies to the entire trust not just assets in isolation (as the current guiding principles dictate).

- Maintains that ERB trustees set investment strategy based on the risk and reward objectives suitable for the trust and its beneficiaries.

- Removes legal lists. Allows ERB trustees to invest in any asset that conforms to the prudence standard and achieves the risk/reward objectives of the trust.

- With changing and dynamic investment markets, allows ERB trustees to invest in any asset that meets the higher standard of prudence. This provides the trust greater flexibility and options to improve the performance of the fund while holding or decreasing risk.

PERFORMANCE IMPLICATIONS

State investment agencies believe that their investment performance will improve by having investments governed by the UPIA instead of legal lists.

FISCAL IMPLICATIONS

According to ERB, moving from the current "legal list" to the UPIA can have a significant impact on the future performance of the ERB fund. ERB estimates that investing under the UPIA will enhance ERB fund returns by 0.26% (26 one-hundredths of one percent) annually. In addition, it would also allow ERB to further diversify the fund and likely reduce investment risk to minimize losses during negative market periods. Because new asset classes could not be fully implemented for FY06, the positive fiscal impact is approximately $8 million in FY06. However, when the changes can be fully implemented the positive fiscal impact will be larger; $30 million for FY07, $55 million for FY08, and $83 million for FY09.

ADMINISTRATIVE IMPLICATIONS

If this bill were to become law, the Educational Retirement Board would not be able to invest in any new options until such time as alternative investments were approved as eligible investments by its board.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The Legislative Finance Committee has endorsed legislation that will eliminate the state investing agencies (SIC, PERA an ERB) current legal lists of permissible investments and replace them with the higher standard of the UPIA. SIC, PERA and ERB support this legislation.

SB 60, sponsored on behalf of the State Permanent Fund Task Force, eliminates the state investing agencies (SIC, PERA an ERB) current legal lists of permissible investments and replaces them with the higher standard of the UPIA

TECHNICAL ISSUES

PERA recommends that for clarification specific reference be made to the Uniform Prudent Investor Act, Chapter 45, Article 7, NMSA 1978.

ALTERNATIVES

PERA notes that the investing agencies (PERA, ERB and SIC) have jointly made technical changes to Legislative Finance Committee-sponsored legislation drafted to replace each investing agency's current "legal list" of permissible investments with higher standard of investing under the UPIA. PERA believes the LFC-sponsored legislation will have all the technical drafting changes recommended by the investing agencies and recommends the alternative language of that bill be used.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

ERB will continue to invest its assets under its current legal list of permissible investments and its board's investment guidelines. ERB believes failure to pass legislation of this type will hamper future investment performance.

POSSIBLE QUESTIONS

1) How has ERB's investment performance been harmed by the legal list?

2) If the legislature provides additional investment flexibility to ERB by implementing the Uniform Prudent Investor Act, what other statutes or rules will protect the fund by regulating the conduct of ERB's board and staff?

3) What are some of the risks associated with new assets classes such as real estate and hedge funds?

4) Elaborate on how the UPIA provides for a higher standard of care by the board trustees and staff.

GGG/yr/njw