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

SPONSOR Carraro **DATE TYPED** 1/28/04 **HB**

SHORT TITLE Financial Advisor Procurement Code Exemption **SB** 61

ANALYST Geisler

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	FY06			
		See narrative	Recurring	Pension Funds and, State Permanent Funds

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates: HB 387
Relates to: SB 60, SB 392, HB 389

SOURCES OF INFORMATION
LFC Files
State Investment Council (SIC)
Public Employees Retirement Association (PERA)
Educational Retirement Board (ERB)
General Services Department (GSD)

SUMMARY

Synopsis of Bill

Senate Bill 61 is sponsored by the State Permanent Fund Task Force and exempts from the procurement code contracts for investment advisory services, investment management services and investment-related services entered into by the Educational Retirement Board (ERB), Public Employees Retirement Association (PERA) and State Investment Council (SIC).

Significant Issues

According to testimony provided by the investing agencies to both the State Permanent Fund Task Force and the Legislative Finance Committee, it take a minimum of six (6) to ten (10) months to award a contract for investment managers or investment related programs under the current procurement code. This hampers the ability of these agencies to be respond in a timely manner to changes in market conditions or investment manager performance. By exempting investment related services from the procurement code, the agencies (with approval of their governing boards) can streamline the procurement process which will improve their ability to manage their investment portfolios.

GSD suggests that the implementation process undertaken by these agencies to streamline the procurement process should identify how the agencies will insure fairness and the best price for the taxpayers

PERFORMANCE IMPLICATIONS

SB 61 will assist the investing agencies in meeting their performance measures. They anticipate they will be able to issue requests for proposals and subsequent contracts in a more efficient timeframe. This will improve annualized investment returns while reducing the risk of the portfolio, which will contribute these agencies exceeding their internal benchmarks for investment return.

FISCAL IMPLICATIONS

By streamlining the ability to contract for investment-related services, the investing agencies should be able to enhance returns on its portfolio while reducing overall risk. In addition, the agencies will have the authority to consider transition costs as an evaluation factor in the RFP process. In a typical RFP, transition costs for hiring a new investment manager can easily run 10 to 50 basis points (a basis point is 1/100 of a percent).

ADMINISTRATIVE IMPLICATIONS

The investing agencies will develop an internal purchasing policy with guidelines for the contracting for investment-related services and the use of internet-based search resources. If given the authority to reduce time periods for published notices and amendments, the award of investment manager contracts and transitioning of portfolio assets may occur in market-sensitive timeframe.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates House Bill 387. Relates to Senate Bill 60, and House Bill 389/Senate Bill 392, all of which propose to improve the investment efficiency of ERB, PERA, and SIC by eliminating the legal list of investments and making the Prudent Investor Act the governing authority over investment decision making.

OTHER SUBSTANTIVE ISSUES

<u>The Procurement Process for Investment Agencies</u>

The investing agencies frequently conducts several investment manager searches per year. These searches are conducted in compliance with the New Mexico Procurement Code, NMSA 1978, §13-1-1 et seq. For each RFP issued, approximately 50 responses are received, all of which must be evaluated. On average, each procurement is a minimum 6-month process. Under the procurement code, multi-term contracts for professional services may not exceed 4 years. The practical implications for investment-related services are significant for the investing agencies. When contracting with an investment manager, an RFP must be issued for the investment product(s) under that manager's control during the last year of the 4-year contract term. Often, the outcome of the RFP is to award contract to the same investment manager after of a 6-month procurement process.

In addition, the agencies currently are unable to consider transition costs as an evaluation factor in the RFP process. In a typical RFP, transition costs for hiring a new investment manager can easily run 10 to 50 basis points. Further, certain asset classes private equity require long-term investments for gains to be realized. Specifically, investment in real estate and require a time horizon to longer than 4-years to realize gain.

In the event of a contracted investment manager's negative performance, the investment agency may decide early termination of the contract is appropriate. Unfortunately, procuring for an alternative investment manager that deals in the same investment product is at best a 6-month process. The procurement code precludes agencies from contracting with the "runner-up" in the previous RFP for the investment product. The only alternative available to agencies is to transition a terminated manager's portfolio to an existing manager under contract who often manages another product. As a result, an investing agencies overall asset allocation portfolio can be negatively impacted.

Lowest Cost versus Best Value

The procurement code contemplates contracting for services based on the "lowest" bid or cost. For trustees of a pension fund, such as PERA, the primary purpose is to select investment managers on the basis of the expected investment return vs. risk, net of cost, rather than the provider with the lowest operating cost. Since most investment manager contracts are negotiated using performance fees, factors such as performance and securities exchange commission charges or investigations are more relevant to manager selection than cost.

Streamlining the Procurement Process

The investing agencies have researched internet-based software applications that allow institutional investors to research, evaluate and select investment products across asset classes and vehicle types. One such software application has a database of approximately 750 investment managers and 3,500 products. The investing agencies believe that use of a software application of this type would provide the administrative convenience of allowing most, if not all, of its responses to a request for proposals (RFP) to be received on-line for easy search and comparison. The investing agencies will need to issue a RFP for such an internet-based software application.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

PERA will continue to comply with the procurement code provisions as they relate to procurement of investment-related services. Given the restraints of procuring new investment manager services and the inability to utilize internet resources, there are no guarantees that PERA will be as successful in the future with its investment returns as it has been over the past ten-year period.

AMENDMENTS

The SIC has identified a potential conflict between §13-1-98.L and the proposed language in 13-

1-98.Y. The SIC believes that any ambiguity in this language could be clarified with a simple addition to the language in §13-1-98.L. The SIC proposes the following amendment to the bill.

1. Recommended change to clarify §13-1-98.L.

    a. "L. the issuance, sale and delivery of public securities pursuant to the applicable authorizing statute, with the exception of bond attorneys and general financial consultants <u>providing services related to the issuance of public securities</u>;"

GGG/yr