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

SPONSOR Sapien **ORIGINAL DATE** 02/11/13 **LAST UPDATED** **HB**

SHORT TITLE Private Equity Investment Advisory Committee **SB** 223

ANALYST Walker-Moran

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$6.5	$6.5	$13.0	Recurring	SIC Budget

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HB 401, SB 9, SB 357.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Economic Development Department (EDD)
State Investment Office (SIC)
State Treasurer's Office (STO)
State Land Office (SLO)
Attorney General's Office (AGO)

SUMMARY

Synopsis of Bill

Senate Bill 223, endorsed by the investments and pensions oversight committee, amends section 7-27-5.15 NMSA 1978 and 7-27-5.26 NMSA 1978 to remove the private equity investment advisory committee (PEIAC) and place oversight and investment management with the State Investment Council (SIC).

The bill increases the experience requirement needed to manage the New Mexico private equity fund to 10 years (from three years).

The bill removes the requirement that investments of the Severance Tax Permanent Fund be made in New Mexico aerospace businesses that have received an award from the US government or one of its agencies or instrumentalities of at least $100 million.

Investments in a single New Mexico business will represent no more than 40 percent (rather than

51 percent) of the total investment capital in a business.

Senate Bill 223 amends section 58-29-6 NMSA 1978 related to the Small Business Investment Corporation (SBIC) to include the state investment council as one of those that receives an annual report indicating the business done by the corporation during the year. In addition to the report the president shall submit a report by April 1 of each year to the SIC regarding the corporation's debt investments and equity investments and the returns on those investments.

This bill repeals section 6-8-20 NMSA 1978 which created the PEIAC.

The effective date of this bill is July 1, 2013.

FISCAL IMPLICATIONS

The SIC would experience a slight decrease in overall budget expenditure due to per diem savings as the current duties of the PEIAC are merged with the SIC's Investment Committee.

The PEIAC is currently composed of 5 statutory members, 4 of whom are eligible for per diem, and 3 of whom currently accept it. Costs per meeting due to per diem are roughly $800/meeting, and on average there are 8 such meetings per year. Additional meeting material and mailing costs comprise the remaining fiscal impact estimate.

While the PEIAC's duties will be absorbed by the SIC's Investment Committee, there is a possible savings might be limited or less than expected due to addition of additional members from the PEIAC to the Investment Committee.

Per EDD, the amended language that eliminates "nationwide" businesses to "businesses in NM" may limit diversification and result in slow turnover to reinvest.

SIGNIFICANT ISSUES

As reported by the SIC, the PEIAC was put in place in the 1990s when private equity investments were viewed as unconventional, new and in need of a highly specialized additional layer of expertise and due diligence. While private equity investments retain a higher risk/reward profile than standard stocks or bonds, they are widely accepted today as a mainstream strategy for institutional investors like the SIC. The SIC has now formed a well-functioning Council Investment Committee (CIC) which will assume the current role of the PEIAC, and has significant private equity experience, comparable to the PEIAC.

Currently, and similarly to the PEIAC, the SIC's investment Committee is appointed by its board to include members of the Council and qualified experts and specialists in various investment strategies. The work of the PEIAC by practice, is largely duplicative of the tasks charged to the Council Investment Committee. SB 223 seeks to remove that redundancy.

It is noteworthy that while the SIC will realize cost savings with this repeal, and remove unnecessary administrative burden, the Council itself will retain final investment authority regarding approval of rejection of all investments.

In addition, the Council and its Investment Committee will still receive guidance analysis and recommendations regarding investments from appropriate advisors and fiduciaries hired to evaluate private equity investments both nationally and in New Mexico. Abolition of the PEIAC in no way increases the risk of inappropriate behavior in connection with private equity investing. On the contrary, it would enable the SIC to better evaluate overall investment risk and implement best practices across the portfolio level. Repeal of the PEIAC advances the Council's commitment to implement best investment & governance practices for the SIC.

In addition, SB 223 seeks the following beneficial changes to existing statute:

- New Mexico private equity fund management will be strengthened by requiring a manager with ten (not three) years of applicable experience.
- Any investment which meets requisite criteria will be permitted; the mention of aerospace businesses is too limiting, and is no longer needed.
- The SIC's total capital invested in any NM business will be reduced from 51 percent to 40 percent, thus improving overall portfolio diversification and reducing concentration risk.
- An additional report must be annually submitted to the SIC regarding SBIC debt and equity investments.

According to the SLO, the SIC would not have the benefit of review and recommendation of the PEIAC when making private equity investments of the STPF in New Mexico businesses, New Mexico private equity funds, or films produced in New Mexico.

PERFORMANCE IMPLICATIONS

SIC perceives little obvious improvement in performance by shifting oversight from the PEIAC to the SIC Investment Committee, but one could argue that better continuity in the investment process will ultimately benefit returns.

Strengthening experience requirements regarding NM private equity management may help long-term investment performance, although to what level is indeterminate.

Reduction of overall allowable ownership of individual companies will prevent overexposure to any one investment, and will help ensure proper alignment of interests with qualified co-investors.

ADMINISTRATIVE IMPLICATIONS

No administrative fiscal implications for EDD as the reviewing agency relating to film investments are foreseen; however, the amended authorization amount of investment in NM businesses by the State Investment Officer to 40 percent from 51 percent correlates to a cost savings to the Severance Tax Permanent Fund.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Both SB 357 and HB 401 propose non-related amendments to the same statutory section: NMSA 1978 § 7.27.5.15

TECHNICAL ISSUES

This bill reconciles multiple amendments to the same section of Law in Law 2007.

OTHER SUBSTANTIVE ISSUES

Additional reporting requirement regarding the SBIC investments is a priority for the SIC. SBIC assets have declined from $48M to approximately $36M since last funded in 2007.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

According to the SIC, failure to pass SB223 will not allow the SIC to take an additional step toward optimizing and professionalizing its operations and improving governance efforts.

EWM/blm