

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: SB141
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue #4
 Title An Act relating to the teachers' and public RDU Taxation & Treasury
employees' retirement systems Component State Pension Custody and
 Sponsor Finance Management Fees
 Requester _____ Component No. 2311

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1029 PERS Retirement	(20,692.8)	(20,692.8)	(20,692.8)	(20,692.8)	(20,692.8)	(20,692.8)
1034 Teachers Retirement	(10,760.9)	(10,760.9)	(10,760.9)	(10,760.9)	(10,760.9)	(10,760.9)
1042 Judicial Retirement	(328.4)	(328.4)	(328.4)	(328.4)	(328.4)	(328.4)
1045 National Guard Retirement	(131.5)	(131.5)	(131.5)	(131.5)	(131.5)	(131.5)
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)	(31,913.6)

Estimate of any current year (FY2005) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

See attached analysis.

Prepared by: Betty Martin, Comptroller Phone 465-2352
 Division Treasury Date/Time 4/5/05 3:28 PM
 Approved by: Tom Boutin, Deputy Commissioner Date 4/5/2005
 Agency Department of Revenue

SB141 creates a new 9 member Alaska Retirement Management (ARM) Board and replaces the current 8 member Alaska State Pension Investment Board (ASPIB) staffed by the Treasury Division. It also creates a defined contribution plan with employee and employer contributions, a separate defined benefit health fund and a health care reimbursement trust. Funds currently budgeted under the ASPIB will be transferred to the new board. A summary of the fiscal notes follows.

Summary of Fiscal Notes	FY06	FY07	FY08	FY09	FY10	FY11
Treasury Division fiscal note #1	214.5	214.5	214.5	214.5	214.5	214.5
Alaska State Pension Investment Board fiscal note #2	-4,144.4	-4,144.4	-4,144.4	-4,144.4	-4,144.4	-4,144.4
ARM Board fiscal note #3	4,734.6	4,410.6	4,410.6	4,410.6	4,410.6	4,410.6
ASPIB Custody and Management Fees fiscal note #4	-31,913.6	-31,913.6	-31,913.6	-31,913.6	-31,913.6	-31,913.6
ARM Board Custody and Management Fees fiscal note #5	31,913.6	31,913.6	31,913.6	31,913.6	31,913.6	31,913.6
Total	804.7	480.7	480.7	480.7	480.7	480.7
Back out IA between the two components ¹	-214.5	-214.5	-214.5	-214.5	-214.5	-214.5
SB241 Total incremental costs	590.2	266.2	266.2	266.2	266.2	266.2

Note 1: Currently 100% of the Treasury Division's personal services costs are included in the Treasury Division component under personal services. These incremental costs are included in the new ARM budget (as in the prior ASPIB budget as a contractual expense). Simply adding the two budgets would double count this amount.

The following table shows the breakdown of incremental costs by budget category. Following are discussed the assumptions we have made and how these total costs have been allocated between fiscal note 1 and 3.

	FY06	FY07	FY08	FY09	FY10	FY11
Personal Services	214.5	214.5	214.5	214.5	214.5	214.5
Travel	23.9	12.0	12.0	12.0	12.0	12.0
Contractual	337.3	39.2	39.2	39.2	39.2	39.2
Supplies	14.5	.5	.5	.5	.5	.5
SB141 Total incremental costs	590.2	266.2	266.2	266.2	266.2	266.2

Assumptions:

Following are the assumptions used in arriving at the estimate of the incremental costs of SB141.

1. A new defined contribution plan will have a similar number and type of options as the current Supplement Benefits System. All options would be available on day one of the new plan. A plan similar to SBS will result in the hire of approximately 6 managers and the establishment of over 30 additional safekeeping accounts at the custodial bank and associated accounting records.
2. There is a need to add 2 additional professional and 1 additional technical staff to include a State Investment Officer II, an Accountant IV and an Accounting Technician III. The total cost included in the fiscal notes per year of these staff is \$214.5.
3. Funding for one extra board meeting in the first year for the new board to organize and receive start-up training as well as funding to reflect 1 additional board member traveling (current budget includes 8 existing members).

4. The costs of computers, office equipment and office space reconfiguration is included in year one for the new staff. In all years funding is included for training, investment software subscriptions (Bloomberg, Yieldbook, S&P and Moody's rating services) and miscellaneous supplies for new staff.
5. In year one, the cost for the external consultant to assist the board in selecting 6 new managers. The current contract cost for manager searches is \$30.0 per search.
6. The costs of an external consultant to calculate performance of the funds quarterly. Costs are expected to be \$30.0/year based on the current contract.
7. In FY2006 \$100.0 to cover the costs of an independent audit/review of the performance consultant. It is a requirement in SB141 that this contractor be audited. We expect that audit to occur every 4 to 5 years after the initial audit/review.
8. There is a \$40.0 reduction in current costs associated with the election of members as the new board will be appointed by the governor.

Treasury Division fiscal note #1

The Treasury Division's fiscal note includes \$214.5 each year for personal services. There are economies of scale in managing investments. However, the new funds created by Senate Bill 141 would require considerable additional responsibilities. If the number of options paralleled the existing SBS Plan, that would translate to 13 new manager accounts, 34 new custodial accounts and 4 new sets of monthly financial statements with annual audit requirements. The Department of Revenue currently manages a large number of funds with a limited investment and back office staff. In order to prudently meet the prospective demands of Senate Bill 141, Treasury would need to hire an additional investment staff and 2 middle/back office staff.

Background

Prudent and productive management of investments is a resource intensive process. Managing a modern portfolio is a broad responsibility which requires significant expertise and high attention to detail.

Investment management responsibilities include designing investment policy guidelines, developing custom asset allocations, conducting investment manager searches, performing investment manager due diligence, negotiating and contracting with prospective managers, managing investment manager relationships, performing periodic portfolio rebalancing, monitoring and evaluating investment performance, presenting and consulting with oversight organizations, and following developments in investment research and analytic tools.

In addition, investment management requires a significant interface with back and middle office functions including fund accounting and audit, managing custody and brokerage relationships, cash management, securities lending, safeguarding assets, and compliance monitoring.

Senate Bill 141 would create the equivalent of four new funds to manage: the Employee Defined Contribution Accounts, the Employer Vesting Accounts, the Medical Program Fund, and the Health Reimbursement Arrangement Trust.

The Employee Defined Contribution Accounts would likely offer employees a reasonably wide range of investment options. As a comparison, the Supplemental Benefits System offers a suite of 6 target or life-style funds and 8 separate asset class funds for a total of 14 options that participants may select from. Deciding on the mix of investment styles to offer, searching for and hiring investment managers, and evaluating and reporting on investment manager performance would be a considerable on-going undertaking.

While Treasury may realize fee economies from existing investment relationships, it is unlikely that the contributions in this account can be commingled with existing accounts. That means that there would be a completely new set of accounts for custodial and accounting purposes.

The Employer Vesting Accounts, the Medical Program Fund, and the Health Reimbursement Arrangement Trust would all likely call for separate custom asset allocations. All three would individually require evaluation, reporting, and periodic portfolio rebalancing. They would also require separate custodial and accounting records including monthly financial reporting and audits.

There is likely to be an additional consequence of the change to a defined contribution plan. Currently there is a population of participants in SBS and Deferred Compensation that monitor their accounts daily. They often have questions whenever there are apparent anomalies in the change in the daily prices of the options. As a general rule, we would say that members of a defined benefit plan are not as price sensitive. The new plan will greatly increase the number of individuals who are monitoring on-line data on a daily basis. This will correlate directly to an increase in the amount of time we spend answering questions.

Alaska State Pension Investment Board fiscal note #2

Alaska Retirement Management Board fiscal note #3

Fiscal note #2 transfers the existing ASPIB budgeted funding to the new ARM board. This fiscal note also includes the ARM board's share of costs expected due to the implementation of SB141.

	FY06	FY07	FY08	FY09	FY10	FY11
ASPIB budgeted funding fiscal note	4,144.4	4,144.4	4,144.4	4,144.4	4,144.4	4,144.4
Incremental costs from SB141	590.2	266.2	266.2	266.2	266.2	266.2
Total costs on fiscal note #3	4,734.6	4,410.6	4,410.6	4,410.6	4,410.6	4,410.6

Total first year costs in fiscal note #3 include \$180.0 for manager selection; \$100.0 for an audit of the board's performance consultant (This audit is a new requirement of SB141. It does not have to occur in the first year, but once done we would expect it to occur every 4 to 5 years.); \$15.0 associated with one additional meeting for organizing and educating the new board members; and, \$29.0 for computers and the office setup for the new positions. These total start-up costs are \$324.0.

On-going costs include interagency chargeback to the ARM for the costs of the 3 new positions totaling \$214.5; travel for the additional board member (the current board has 8 members versus the new board with 9 members) as well as increased due diligence of the new fund managers and training for the new staff in the amount of \$13.0; \$48.7 for the ongoing cost of phones, information technology charge backs, supplies and investment subscription services for the new staff (these include Bloomberg, Yieldbook, S&P and Moody's and Tradeweb); a \$<40.0> reduction in current cost as elections will be eliminated; \$30.0 per year for the calculation of the new funds' performance by an external consultant. These total on-going costs are \$266.2.

State Pension Custody and Management Fees #4
Alaska Retirement Management Board Fees #5

Fiscal note #4 transfers the budgeted funding of the State Pension Custody and Management Fees to a new Alaska Retirement Management Board Fees component (fiscal note #5) in the Department of Revenue for the new ARM Board. This component includes the investment management and custody costs of the existing defined benefit plans and will not be impacted in the foreseeable future by SB141. Please note that in a defined contribution plan, invest manager fees and custodian costs are deducted from the individual accounts daily (through an adjustment to the per share price of the investments). These costs are not included in the Department's budget.

	FY06	FY07	FY08	FY09	FY10	FY11
ASPIB Custody and Management Fees fiscal note #4	-31,913.6	-31,913.6	-31,913.6	-31,913.6	-31,913.6	-31,913.6
ARM Board Custody and Management Fees fiscal note #5	31,913.6	31,913.6	31,913.6	31,913.6	31,913.6	31,913.6