LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 80TH LEGISLATIVE REGULAR SESSION

April 11, 2007

TO: Honorable Vicki Truitt, Chair, House Committee on Pensions & Investments

FROM: John S. O'Brien, Director, Legislative Budget Board

IN RE: **SB247** by Ellis (Relating to prohibiting the investment of state funds in certain private business entities doing business in Sudan.), **As Engrossed**

Estimated Two-year Net Impact to General Revenue Related Funds for SB247, As Engrossed: an impact of $0 through the biennium ending August 31, 2009.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2008	$0
2009	$0
2010	$0
2011	$0
2012	$0

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue Gain/(Loss) from *S.E.R.S. Trust Account* 955	Probable Revenue Gain/(Loss) from *TRS TRUST ACCOUNT FUND* 960
2008	($12,402,334)	($51,100,000)
2009	($1,239,419)	($4,027,000)
2010	($1,267,715)	($4,338,100)
2011	($1,299,548)	($4,664,500)
2012	($1,331,382)	($5,393,800)

Fiscal Year	Change in Number of State Employees from FY 2007
2008	2.0
2009	2.0
2010	2.0
2011	2.0
2012	2.0

Fiscal Analysis

The bill would add a new chapter to Subtitle F, Title 10 of the Government Code to prohibit state funds from being invested, or remaining invested, in publicly traded securities of certain companies that engage in business operation in the country of Sudan.

The bill would require the Comptroller to compile, maintain, and update a list of "scrutinized companies" that engage in business activities in Sudan. Each state governmental entity would have to identify any scrutinized companies in which the state governmental entity owned direct or indirect holdings. Depending on the type of business operations a scrutinized company was engaged in, the state governmental entity would have to send written notice to the scrutinized company encouraging or warning that company to refrain from business activities in Sudan. If, after a specified timetable, the company continued to have scrutinized active operations in Sudan, the state governmental entity would have to divest its assets of the scrutinized company.

The bill would require the Employees Retirement System of Texas (ERS) to identify those companies that are owned by ERS from the list of scrutinized companies provided by the Comptroller.

Annually, each state agency would have to file a public report summarizing its compliance with the provisions of the new chapter. The new chapter would expire if the U.S. government declared that the Darfur genocide had been halted for at least 12 months, if the U.S. government declared that mandatory divestment of the type provided for in the chapter interfered with the conduct of U.S. foreign policy, or if the U.S. revoked its sanctions against the government of Sudan.

Methodology

The affected entities' flexibility in choosing investments—and their ability to diversify and reduce risk—could be reduced.

The Teacher Retirement System has conducted a review of its holdings as of December 31, 2006 and determined that actual losses would be estimated at about $51 million with on-going losses in future years, based on a comparison of the performance of Sudan-related holdings as compared with the International Equity Index. Implementing the provisions of the bill would require the addition of one FTE at TRS at an annual cost of $100,000 paid out of the TRS Trust Account Fund to monitor business activities of “scrutinized companies,” to maintain the list of holding in such companies, to communicate with these companies, and to prepare the annual report required by the bill. The maximum potential loss for divestment for TRS in fiscal year 2008 associated with the 30 basis point limit in the bill is estimated at about $300 million. Estimated losses above reflect the agency's estimated losses of $51 million in the first year under the provisions of the bill and ongoing losses based on an 8 percent annual return on investment assumption, less investment costs.

According to ERS, the maximum potential loss from divestment in FY 2008 could be 30 basis points of $23 billion or $69 million. This assumes that the full loss would be realized in FY 2008. It is also possible that the full amount of the loss might not be realized until subsequent years. There would be additional incremental losses from divestment each year as the value of ERS’ assets under management increase and the maximum divestment amount also increases. The estimates in the table above are based on proportionate application of the TRS impact described above. The projected ongoing loss has been calculated using the actuarially assumed rate of return of 8 percent, less deductions for retirement benefits and agency administrative expenses.

Currently, ERS does not have any positions that perform the functions required by the bill. ERS estimates that one new FTE would be essential in supporting the engagement activities with the scrutinized companies, coordinating with the Comptroller's Office, and meeting the reporting requirements of the bill.

Cost to defend ERS, its board and staff for any action that could be brought as a result of compliance with the statute are not included in the above cost estimates.

Note: The prohibition against the investment in publicly traded securities of companies doing business in Sudan could be difficult to implement because some of the affected entities have the authority to purchase mutual funds. An investor in a mutual fund may not know what companies are in the fund's investments from day to day. The affected entities' flexibility in choosing investments—and their ability to diversify and reduce risk—could be reduced.

Also, investment losses described above would be offset to the extent that reinvestment strategies by ERS and TRS are as lucrative as the strategies prohibited by the bill's provisions.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 304 Comptroller of Public Accounts, 323 Teacher Retirement System, 327 Employees Retirement System, 720 The University of Texas System Administration

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