BILL # HB2151 **TITLE:** ~~DOA; confidential data positions; fingerprints~~
(NOW: iran; public fund divestment)

SPONSOR: Paton **STATUS:** As Amended by House GOV

PREPARED BY: Eric Billings, Marge Zylla

FISCAL ANALYSIS

Description

This bill would require all public funds managed by the Arizona State Retirement System (ASRS), Public Safety Personnel Retirement System (PSPRS), and the State Treasurer to be divested from any petroleum companies that have invested $20 million or more in Iran in any year since August 5, 1996. The bill exempts indirect holdings, such as mutual funds, from divestment.

Estimated Impact

The bill's fiscal impact includes administrative and transaction related expenses to divest current investments. Based on agency estimates, these costs are projected to be $15,700 - $30,700 from the General Fund and $7.6 million from other funds in FY 2009.

The second potential impact involves the possibility of changes in investment returns, which could affect employer retirement rates. ASRS and PSPRS believe that petroleum divestment would reduce their investment earnings. ASRS projects that the lower earnings would increase employer contribution rates at a cost of $11.5 million to the General Fund and $4.6 million to non-General Fund sources. PSPRS estimates costs of $11.6 million in General Fund monies and $500,000 in non-General Fund monies. These estimates are based on certain assumptions as to what investments would be affected and that the divested monies would be reinvested, on average, at a lower rate of return. Actual costs would depend on how the divestment and reinvestment ultimately occurred.

Analysis

There are 3 potential impacts of this bill, implementation costs, foregone investment returns, and increased retirement rates.

Implementation Costs
The implementation of this bill would require agencies to identify investments that would be subject to divestment. Currently, there is no list of investments that match the provisions of this bill. The total cost of compiling this list could be as high as $90,000 according to individual agency estimates; however, these costs may be reduced and shared between agencies if a statewide list of prohibited investments were produced. Both ASRS and PSPRS expect to contract out for this list, which would result in a one-time cost of $30,000 in non-General Fund monies per agency. The Treasurer would also contract with an outside firm and expects there to be a one-time cost of $15,000 - $30,000 in General Fund monies. There would be some ongoing costs to keep the list up-to-date.

The divestment of relevant assets would cause agencies to incur one-time transaction costs. Transaction costs are typically paid to a broker who buys or sells assets onto the open market and are dependent on the value or volume of assets being traded. As previously noted, no definitive list of companies affected by this bill is currently available; however, the affected agencies estimate $7.5 million in total transaction costs. ASRS and PSPRS estimate non-General Fund costs of $6 million and $1.5 million respectively. The Treasurer estimates General Fund costs of $725. The disparity in costs between the Treasurer and ASRS and PSPRS is due to differences in the types of investments allowed in each agency's portfolio.

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Foregone Investment Returns
The divestment from petroleum related companies with investments in Iran may have a negative impact on the rate of return that agencies are able to obtain on assets under management. In the past several years, petroleum companies have outperformed the broader market and may continue to do so in coming years. The foregone earnings estimates were based on the past 5 year's returns on companies that were determined to be affected by this bill. The total estimate for foregone earnings is $106.6 million for FY 2009. ASRS and PSPRS estimate annual non-General Fund foregone earnings of $84.9 million and $21.3 million respectively. The Treasurer estimates non-General Fund foregone annual earnings of $380,000, which would otherwise accrue to the State Trust Land Endowment Accounts.

Retirement Rates
Decreased earnings would result in higher retirement rates. Both ASRS and PSPRS systems have identified equity investments that may be affected by this bill. Their analysis assumed that the identified investments would be divested, and then reinvested, at the average rate of return for the remainder of the investment pool. The analysis was based on actual data from the previous 5 years. As previously mentioned, because petroleum companies are producing high returns, the ASRS and PSPRS analysis assumes that the rate of return for reinvested monies would be significantly lower.

In the case of ASRS, these lower returns would translate into a rate increase of 105 basis points (1.05%) from 8.95% to 10.0%. This increase would raise the cost of both employer and employee contributions to the retirement system. The state employers' cost is estimated at $11,444,900 from the General Fund and $4,572,300 from Other Appropriated Funds. It would also decrease the funded status from 83% to 79%.

In the case of PSPRS' plans, including the Corrections Officer Retirement Plan and the Elected Officials Retirement Plan, preliminary estimates show these lower returns would translate into an aggregate rate increase of 200 - 300 basis points (2% - 3%). This increase would raise the cost of employer contributions to the retirement system. The state cost is estimated at $11.6 million from the General Fund and $500,000 from Other Appropriated Funds.

Local Government Impact

This bill would reduce investment returns for local government accounts managed by the Treasurer. An estimate of this impact has not been received at this time.

Most local governments also participate in ASRS, PSPRS, CORP and EORP. The retirement rate increases would affect local governments in the same way that they affect the state. The magnitude of the increase would depend on each government's participating salary base.

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