

DEPARTMENT OF THE TREASURY
FY 2019-20 JOINT BUDGET COMMITTEE HEARING AGENDA

Wednesday, December 5, 2018

1:30 pm – 2:30 pm

1:30-1:40 INTRODUCTIONS AND OPENING COMMENTS

Presenter: Charles Scheibe, Chief Operating Officer / Chief Financial Officer

1:40-2:30 QUESTIONS FROM JBC STAFF BRIEFINGS

Main Presenter:

- Charles Scheibe, Chief Operating Officer / Chief Financial Officer

Supporting Presenter:

- Maruti More, Chief Investment Officer

QUESTIONS FROM JBC STAFF BRIEFINGS

Please explain the use of funds from the Unclaimed Property Trust Fund/ Unclaimed Property Program for the Adult Dental Program. Is it statutorily required or permitted?

Response:

CRS 38-13-116.5 (2.8)(a)(I) reads "On and after April 1, 2014, after reserving the amounts described in paragraph (b) of this subsection (2.8), the state treasurer shall transmit to the adult dental fund created in section 25.5-5-207 (4), C.R.S., an amount of principal and interest in the trust fund sufficient to implement the adult dental benefit pursuant to section 25.5-5-202 (1)(w), C.R.S." CDHCPF would need to explain exactly how the money is used.

Should the Pubic School Fund Investment Board move to a policy of passive fund management in order to reduce investment costs? Please have both the Department and the Investment Board respond to this issue and discuss the advantages and disadvantages as well as the difference in cost of a passive investment strategy and an active investment strategy.

Response:

The Department's opinion:

- Active investing seeks to achieve excess return over market returns. However, even truly successful active managers seldom outperform benchmark returns on a consistent basis. Moreover, all investment managers rightfully proclaim that past performance is no guarantee of future returns.
- Passive or index investing and internal investment management tends to be more cost efficient and as good or better than active investing given half the resources. As a result, we are seeing explosive growth in low cost ETFs, index funds, and growing awareness of the advantage of internal vs external investment management for liquid public asset markets to save costs as exemplified by CALPERS and other organizations.
- Investors need consistently more excess returns over benchmark returns to outweigh the higher costs that come with active investing through external investment management. A more balanced approach would be a combination of passive index investing and internal management for public markets like stocks and bonds, and external management for private equity/fixed income, real estate, infrastructure, commodities, currencies, and other illiquid markets.

Summary of Pros and Cons

Pros of Passive Investments

- Likely to perform close to index
- Generally lower fees
- Simplicity: investors know what they are getting

Cons of Passive Investments

- Unlikely to significantly outperform index
- Participate in all of index downside
- Buy/sell decisions based on index, not research

Pros of Active Investments

- Opportunity to outperform index
- Potential for limiting the downside
- Buy/sell decisions based on research

Cons of Active Investments

- Potential to underperform index due to misjudgments
- Generally higher fees depending upon investment complexities

The Board's opinion:

The Board's goal is to deliver attractive risk-adjusted returns to the portfolio which the Board and its advisor believe will entail utilizing a combination of both passive and active investment strategies.

Actively managed funds provide the potential to outperform market benchmarks. Benefits include greater flexibility by having more control over what securities to buy and sell to fit the fund's strategy.

Passive funds try to match the returns of the benchmark. Because there is less managerial involvement, passive funds generally have lower fees.

Active and passive funds have the potential to complement one another in a portfolio.

The question of which approach to use is complicated and much debated. Some factors to consider in determining which to use are: investment timeline, fund goals, and risk tolerance.

The Public School Fund Investment Board, guided by the advice of their investment consultant, currently employs a combined approach. Simplicity and low cost are the preferred path, unless there are specific mandates or constraints that need to be considered.

The 20% equity portfolio is passively managed; while the 80% fixed income portfolio is actively managed. With the fixed dollar distribution policy of \$21 million income and the gain loss make-whole provision, passively managing the fixed income portfolio would be difficult.

The importance of finding qualified fund managers with a strong track record over a long time horizon with lower fees is very important with either strategy. With each fund manager search, there is a thorough vetting/RFP process.

As the Board continues to diversify the Permanent Fund, it will be investing in private assets that can only be managed actively, such as real estate.

Along with their investment consultant, the Board is continually evaluating the merits of each investment decision.

Compare the interest rate that Colorado will pay if it continues to issue COPs pursuant to S.B. 17-267 with the rate it will pay if it issues TRANs pursuant to the 2019 referred measure in S.B. 18-001. Which rate will be higher? What is the rate differential? Are there reasons other than rate differential rates to prefer one instrument over the other?

Response:

Per the State's financial advisor, the ultimate credit package of the TRANs would determine if the interest rates are lower or higher than COPs, but either way it would not be a significant difference. It could range from +/- 15 to 25 basis points.

The TRANs would be easier from the standpoint that there would not be required leased property as there is with a COP, which requires a lot of time on real estate work. Even for the first issuance of SB 267 COPs, the time spent was extensive, and it is anticipated that the time for future issuances would increase exponentially.

ADDENDUM: OTHER QUESTIONS FOR WHICH SOLELY WRITTEN RESPONSES ARE REQUESTED. PLEASE RETAIN THE NUMBERING IN ORDER TO MAINTAIN CONSISTENT LABELING FOR COMMON QUESTIONS ACROSS DEPARTMENTS.

- 1 Provide a list of any legislation that the Department has: (a) not implemented, or (b) partially implemented. Explain why the Department has not implemented or has only partially implemented the legislation on this list. Please explain any problems the Department is having implementing any legislation and any suggestions you have to modify legislation.

Response:

The Department is not aware of any such situations.

- 2 Does the Department have any HIGH PRIORITY OUTSTANDING recommendations as identified in the "Annual Report: Status of Outstanding Audit Recommendations" that was published by the State Auditor's Office and dated June 30, 2018 (link below)? What is the Department doing to resolve the HIGH PRIORITY OUTSTANDING recommendations? [Please indicate where in the Department's budget request actions taken towards resolving HIGH PRIORITY OUTSTANDING recommendations can be found.](#)

Response:

The Department is not aware of any such situations.

<http://leg.colorado.gov/audits/annual-report-status-outstanding-audit-recommendations-june-30-2018>

- 3 If the Department receives federal funds of any type, please respond to the following:
- Are you expecting any changes in federal funding with the passage of the FFY 2018-19 or 2019-20 federal budget? If yes, in which programs, and what is the match requirement for each program?
 - Does the Department have a contingency plan if federal funds are eliminated?
 - Please provide a detailed description of any federal sanctions or potential sanctions for state activities of which the Department is already aware. In addition, please provide a detailed description of any sanctions that MAY be issued against the Department by the federal government during FFY 2018-19 or 2019-20.

Response:

The Department does not receive federal funds of any type. The Department only passes through federal funds to other state agencies and departments.

- 4 Is the Department spending money on public awareness campaigns? If so, please describe these campaigns, the goal of the messaging, the cost of the campaign, and distinguish between paid media and earned media. Further, please describe any metrics regarding effectiveness and whether the Department is working with other state or federal departments to coordinate the campaign?

Response:

The Department has a budget of \$200,000 to spend on an annual campaign to reunite the public with their unclaimed money or property. Every year the Unclaimed Property Division experiences significant spikes in inquiries and claim filings during the campaign. The campaign is within the state and the Department does not coordinate their efforts with other state or federal departments.

- 5 Based on the Department's most recent available record, what is the FTE vacancy and turnover rate by department and by division? To what does the Department attribute this turnover/vacancy? Do the statewide compensation policies administered by the Department of Personnel help or hinder in addressing vacancy or turnover issues?

Response:

The Department had an overall turnover rate of 18% for FY18. One-third of the turnover for the period was due to the departure of senior leadership in the Unclaimed Property Division. Two-thirds of turnover for the period was due to the departure of entry level personnel in the Accounting, Investment, and Unclaimed Property Divisions. Turnover was due to retirements and advancement opportunities. Statewide policies have not had a significant effect on addressing vacancy or turnover issues.

- 6 Please identify how many rules you have promulgated in the past two years (FYs 2016-17 and 2017-18). With respect to these rules, have you done any cost-benefit analyses pursuant to Section 24-4-103 (2.5), C.R.S., regulatory analyses pursuant to Section 24-4-103 (4.5), C.R.S., or any other similar analysis? Have you conducted a cost-benefit analysis of the Department's rules as a whole? If so, please provide an overview of each analysis.

Response:

The Department has not promulgated any rules in the past two years.

- 7 What are the major cost drivers impacting the Department? Is there a difference between the price inflation the Department is experiencing compared to the general CPI? Please describe any specific cost escalations.

Response:

The Department's major cost driver is personnel. The Department is not experiencing a difference.

- 8 How is the Department's caseload changing and how does it impact the Department's budget? Are there specific population changes or service needs (e.g. aging population) that are different from general population growth?

Response:

The Department is not experiencing a changing caseload as it primarily serves other state agencies and departments.

- 9 Please provide an overview of the Department's current and future strategies for the use of outward facing technology (e.g. websites, apps) and the role of these technologies in the Department's interactions with the public.

Response:

The Department's strategies for the use of outward facing technology will be determined by the incoming administration.