The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Governmental Oversight and Accountability Committee

BILL: SB 880

INTRODUCER: Senator Ring

SUBJECT: State Investments

DATE: January 24, 2012 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McKay	Roberts	GO	**Pre-meeting**
2.			BC	
3.				
4.				
5.				
6.				

I. Summary:

This bill increases the amount of money the State Board of Administration can invest in alternative investments from 10 percent to 20 percent. The bill also "resets" a figure for the amount of contributed principal in the Lawton Chiles Endowment Fund.

This bill substantially amends sections 215.47 and 215.5601 of the Florida Statutes.

II. Present Situation:

The State Board of Administration

The State Board of Administration (SBA) is created in Art. IV, s. 4 (e) of the State Constitution. Its members are the Governor, the Chief Financial Officer, and the Attorney General. The board derives its powers to oversee state funds from Art. XII, s. 9 of the State Constitution.

The SBA has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan and the FRS Investment Plan, which represent approximately $128 billion, or 86 percent, of the $149 billion in assets managed by the SBA, as of October 31, 2011. The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees choose in lieu of the Pension Plan. The SBA also manages 33 other investment portfolios, with combined assets of $21 billion, including the Florida Hurricane Catastrophe Fund (CAT Fund), the Florida Lottery Fund, the Florida Pre-Paid College Plan, and various debt-service accounts for state bond issues[1].

In investing assets, the SBA follows the Florida Statutes' fiduciary standards of care, subject to certain limitations.[2] Pursuant to s. 215.444, F.S., a nine-member Investment Advisory Council provides recommendations on investment policy, strategy, and procedures. The SBA's ability to invest the FRS assets is governed by s. 215.47, F.S., which provides for a "legal list" of the types of investments and for how much of the total fund may be invested in each investment type. Some of the key guidelines in the "legal list" specific to the investment of FRS Pension Plan assets include:

- No more than 80 percent of assets should be invested in domestic common stocks.
- No more than 75 percent of assets should be invested in internally managed common stocks.
- No more than 3 percent of equity assets should be invested in the equity securities of any one corporation, except when the securities of that corporation are included in any broad equity index or with approval of the Board; and in such case, no more than 10 percent of equity assets can be invested in the equity securities of any one corporation.
- No more than 80 percent of assets should be placed in corporate fixed income securities.
- No more than 25 percent of assets should be invested in notes secured by FHA-insured or VA-guaranteed first mortgages on Florida real property, or foreign government general obligations with a 25-year default-free history.
- No more than 20 percent of assets should be invested in foreign corporate or commercial securities or obligations.
- No more than 35 percent of assets should be invested in foreign securities.
- No more than 10 percent[3] of assets should be invested in alternative investments,[4] alternative investment vehicles,[5] and other non publicly-traded investments.

Alternative Investments[6]

According to information provided by staff of the SBA, the increase in authority for such investments is needed to implement the recommendations contained in Hewitt EnnisKnupp asset liability studies conducted in 2010 and 2011 for the FRS Pension Plan Trust, and would have the benefit of lowering long-term employer cost. The FRS Pension Plan's relatively low allocation to alternative investments (compared to other large and leading public and corporate pension plans) has detracted from performance during the severe global stock market declines experienced in 2000-02 and 2007-09.

---

[1] State Board of Administration "Monthly Performance Report to the Trustees" as of October 31, 2011, issued November 30, 2011.
[2] Section 215.44, F.S.
[3] The cap on alternative investments was last changed in 2008, when it was raised from 5% to 10% by Ch. 2008-31, L.O.F.
[4] An "alternative investment" is defined in s. 215.4401(3)(a)1., F.S., as "an investment by the State Board of Administration in a private equity fund, venture fund, hedge fund, or distress fund or a direct investment in a portfolio company through an investment manager."
[5] An "alternative investment vehicle" is defined in s. 215.4401(3)(a)2., F.S., as the "limited partnership, limited liability company, or similar legal structure or investment manager through which the State Board of Administration invests in a portfolio company."
[6] All information in this section comes from an SBA analysis of SB 880, on file with the Committee on Governmental Oversight and Accountability.

Hewitt EnnisKnupp's recommendations to modestly increase the allocation to alternative investments were approved by the SBA Investment Advisory Council and Trustees in 2010 and 2011. The SBA Trustees directed the Executive Director to seek expanded statutory authority to invest in alternative investments (and other securities or investments that are not publicly traded and are not otherwise authorized under s. 217.47, F.S.) beyond the current limit of 10%. It would take several years to actually implement an expanded allocation to such investments. As of October 31, 2011, the FRS pension plan had $5.7 billion in private equity, and $4.7 billion in strategic investments.[7]

Lawton Chiles Endowment Fund

In 1999, the legislature created the Lawton Chiles Endowment Fund in s. 215.5601, F.S., to accept monies from the settlement with various tobacco manufacturers, and provide the authority to the SBA to invest the monies for the purpose of funding health and human service initiatives.

Section 215.5601(3)(d), F.S., provides that for fiscal year 2001-2002, $150 million of the existing principal in the endowment is to be accounted for separately, the income from which is to be used for biomedical research activities pursuant to s. 215.5602, F.S., the James and Esther King Biomedical Research Program.

Section 215.5601(4)(b), F.S., provides that the investment objective is the long-term preservation of the "net contributed principal," and also provides that 5 percent of the annual cash outflow dedicated to the biomedical research portion of the endowment shall be reinvested and applied to that portion of the endowment's principal, with the remainder to be spent on biomedical research activities consistent with this section.

III. Effect of Proposed Changes:

Section 1 amends s. 215.47, F.S., to allow the SBA to invest up to 20 percent of any fund in alternative investments, up from the current 10 percent.

Section 2 amends a provision in the Lawton Chiles Endowment Fund in s. 215.5601, F.S., by replacing the phrase "contributed principal" with a specific amount- $434,354,314. According to staff of the SBA[8]:

> The "reset figure" was developed through consultation with stakeholders to roughly coincide with the closest fiscal year end to the large extraordinary appropriations during the global financial crisis. The real value of the endowment was approximately $1.6 billion before the Legislature began reducing the amount through appropriating portions of the endowment for other budget needs during the 2008-09 market collapse. The amount of the endowment as of September 23, 2011 was $697 million. With the proposed resetting, the estimated annual payout for the 2011-2012 fiscal year would increase from $14 million to $18.1 million,

[7] SBA "Monthly Performance Report to the Trustees" as of October 31, 2011.
[8] SBA analysis of SB 880, on file with the Committee on Governmental Oversight and Accountability.

and the payout amounts are projected to increase in the future. All else equal, utilizing a more current "reset figure" would lower the projected distributions.

The bill also changes the amount of the existing principal in the endowment to be accounted for separately, the income from which is to be used for biomedical research activities, from $150 million to $50 million. The bill also deletes a provision that 5 percent of the biomedical research cash outflow must be reinvested and applied to principal.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The changes to s. 215.5601 affect the amount of monies available to support biomedical research.

C. Government Sector Impact:

The changes to s. 215.5601 affect the amount of monies available to support biomedical research.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.