

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1417 State Investments
SPONSOR(S): Oliva
TIED BILLS: **IDEN./SIM. BILLS:** CS/SB 880

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR or BUDGET/POLICY CHIEF |
|---------------------------------------|------------------|---------|--|
| 1) Government Operations Subcommittee | 11 Y, 4 N, As CS | Meadows | Williamson |
| 2) Finance & Tax Committee | 18 Y, 5 N | Wilson | Langston |
| 3) State Affairs Committee | | | |

SUMMARY ANALYSIS

The State Board of Administration (SBA) is created in Art. IV, s. 4(e) of the Florida Constitution. The SBA members are the Governor, the Chief Financial Officer, and the Attorney General. The SBA derives its powers to oversee state funds from Art. XII, s. 9 of the Florida Constitution. The SBA has responsibility for managing investments for the Florida Retirement System (FRS) Pension Plan and for administering the FRS Investment Plan.

The SBA's ability to invest the FRS assets is governed by a "legal list" of investments provided in current law. The "legal list" of guidelines specific to the investment of FRS Pension Plan assets includes the ability of the SBA to invest 10 percent of any fund in alternative investments.

CS/HB 1417 authorizes the SBA to invest up to 20 percent of any fund in alternative investments, up from 10 percent.

The bill should have no direct impact on state or local government revenues or expenditures.

The bill provides for an effective date of July 1, 2012.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Current Situation

The State Board of Administration (SBA) is established by Article IV, s. 4(e) of the Florida Constitution, and is composed of the Governor as Chair, the Chief Financial Officer as Treasurer, and the Attorney General as Secretary. The SBA members are commonly referred to as “Trustees.” The SBA derives its powers to oversee state funds from Art. XII, s. 9 of the Florida Constitution.

The SBA has responsibility for managing investments for the Florida Retirement System (FRS) Pension Plan and for administering the FRS Investment Plan, which represent approximately \$125.1 billion (85 percent) of the \$147.5 billion in assets managed by the SBA, as of November 30, 2011.¹ The SBA also manages 33 other investment portfolios, with combined assets of \$21.7 billion², including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, the Florida Pre-Paid College Plan, and various debt-service accounts for state bond issues.

The SBA must follow fiduciary standards of care when investing assets, subject to certain limitations.³ A six-member Investment Advisory Council provides recommendations on investment policy, strategy, and procedures.⁴

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. The “legal list” of guidelines⁵ specific to the investment of FRS Pension Plan assets includes the authorization to invest no more than 10 percent of assets in alternative investments⁶, alternative investment vehicles⁷, and other non publicly-traded investments.⁸ The cap on alternative investments was last changed in 2008, when it was raised from five percent to 10 percent.⁹

¹ See State Board of Administration of Florida, *Monthly Performance Report to the Trustees*, November 30, 2011, issued December 31, 2011, at 7 (on file with the Government Operations Subcommittee).

² *Id.*

³ See s. 215.44, F.S.

⁴ See s. 215.444, F.S.

⁵ The legal list of guidelines specific to the investment of FRS Pension Plan assets includes:

- 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 three 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 of assets should be invested in alternative investments, alternative investment vehicles, and other non publicly-traded investments.

⁶ Section 215.4401(3)(a)1., F.S., defines an “alternative investment” 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.”

⁷ Section 215.4401(3)(a)2., F.S., defines an “alternative investment vehicle” 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.”

⁸ See s. 215.47, F.S.

⁹ See chapter 2008-31, L.O.F.

Currently, the SBA has nine percent of its funds invested in alternative investments.¹⁰ Current alternative investments include strategic investments¹¹ and private equity^{12, 13}. As of November 30, 2011, the pension plan had \$5.7 billion in private equity, and \$4.9 billion in strategic investments.¹⁴ The SBA's current allocation to alternative investments is relatively low compared to other large and leading public and corporate pension plans.¹⁵

Hewitt EnnisKnupp¹⁶ (HEK) performed asset liability studies on the SBA's investment strategy in 2010 and 2011. The recommendations from the studies provided by HEK would require the SBA to have increased authority to allocate funds to alternative investments.¹⁷ HEK's recommendations to increase the allocation to alternative investments were approved by the SBA Trustees and the SBA Investment Advisory Council in both 2010 and 2011.¹⁸

Effect of Proposed Changes

The bill authorizes the SBA to invest up to 20 percent of any fund in alternative investments, up from the current 10 percent.

B. SECTION DIRECTORY:

Section 1: Amends s. 215.47, F.S., to increase the amount of money that may be invested in alternative investments by the SBA.

Section 2: Provides an effective date of July 1, 2012.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

¹⁰ Information provided by electronic mail on February 2, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration (on file with the Government Operations Subcommittee).

¹¹ Strategic investments may include: debt oriented funds, infrastructure, absolute return funds, long and short equity, global macro and multi-strategy funds, commodities, and timberland. Definition provided by electronic mail, on February 2, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration (on file with the Government Operations Subcommittee).

¹² Private equity is investment strategies that provide working capital to companies in order to nurture expansion, new product development, or the restructuring of operations, management, or ownership. Definition provided by electronic mail, on February 2, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration (on file with the Government Operations Subcommittee).

¹³ Information provided by electronic mail, on February 2, 2012, by Mr. Ron Poppell, Senior Defined Contribution Programs Officer, State Board of Administration (on file with the Government Operations Subcommittee).

¹⁴ See State Board of Administration of Florida, *Monthly Performance Report to the Trustees*, November 30, 2011, issued December 31, 2011, at 7 (on file with the Government Operations Subcommittee).

¹⁵ Analysis of HB 1417, State Board of Administration, January 10, 2012, at 2 (on file with the Government Operations Subcommittee).

¹⁶ Hewitt EnnisKnupp is an advisor to institutional investors, including numerous large public pension funds such as the one overseen by the SBA.

¹⁷ Analysis of HB 1417, State Board of Administration, January 10, 2012, at 2 (on file with the Government Operations Subcommittee).

¹⁸ *Id.*

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The increase in alternative investment capacity will allow for greater access to state investments for portfolio investment managers.

D. FISCAL COMMENTS:

The bill may have impacts, unknown at this time, on returns earned by the SBA on its invested funds.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. The bill does not appear to affect county or municipal governments.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill does not appear to create a need for rulemaking or additional rulemaking authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 6, 2012, the Government Operations Subcommittee passed a proposed committee substitute for House Bill 1417. The committee substitute removes from the bill changes made to the Lawton Chiles Endowment Fund.

The analysis is drafted to the committee substitute as passed by the Government Operations Subcommittee.