



## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

Provide limited government – The bill increases the authority of the State Board of Administration related to invalid distributions and authorized investments.

#### B. EFFECT OF PROPOSED CHANGES:

##### Public Employee Optional Retirement Program

In 2000, the Florida Legislature created the Public Employee Optional Retirement Program in part II of chapter 121, Florida Statutes. The State Board of Administration, which is responsible for establishing the program, calls this program the Florida Retirement System (FRS) Investment Plan in order to distinguish it from the FRS defined benefit program, the FRS Pension Plan.<sup>1</sup> The FRS Investment Plan is a defined contribution retirement plan in which employer contributions, based on membership class, are made to an account established for the participant. The participant can then choose, from a number of investment funds which “span the risk-return spectrum,” how to invest those contributions.<sup>2</sup>

New employees of FRS employers are automatically enrolled in the FRS Pension Plan on the first day of their employment.<sup>3</sup> Within five months following their month of hire, these new employees may elect to participate in the FRS Investment Plan instead of the FRS Pension Plan.<sup>4</sup> Employees of FRS employers also have a one-time option to change their retirement plan from the FRS Investment Plan to the FRS Pension Plan or from the FRS Pension Plan to the FRS Investment Plan.<sup>5</sup>

##### Transfers from the FRS Pension Plan to the FRS Investment Plan

Transfers from the FRS Pension Plan to the FRS Investment Plan are governed, in part, by s. 121.4501(3)(c), F.S. If a participant elects to transfer the present value of the employee’s accumulated benefit obligation earned under the Pension Plan, the Division of Retirement must transfer the funds within 30 days of the employee beginning participation in the Investment Plan. With these time constraints, the Division must use estimates of the employee’s creditable service<sup>6</sup> and average final compensation.<sup>7</sup> Within 60 days of the initial transfer, the Division must “true-up” the transfer - recomputing the amount transferred based on the participant’s creditable service and average final compensation as of the date of FRS Investment Plan participation.<sup>8</sup> If the recomputed amount indicates, by \$10 or more, that excess funds were transferred from the FRS Pension Plan, the Division of Retirement is required to transfer the excess funds from the participant’s FRS Investment Plan to the FRS Pension Plan, based upon six percent effective annual interest, compounded annually, pro rata based on the participant’s allocation plan.<sup>9</sup> If the recomputed amount indicates, by \$10 or more, that insufficient funds were transferred from the FRS Pension Plan, the Division of Retirement is required to

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<sup>1</sup> Fla. State Board of Admin., Fla. Ret. Sys. Summary Plan Description - FRS Investment Plan (Sept. 1, 2005), available at [http://www.rol.frs.state.fl.us/myfrs/forms/pdf/frs\\_ip\\_spd.pdf](http://www.rol.frs.state.fl.us/myfrs/forms/pdf/frs_ip_spd.pdf) (last visited Mar. 12, 2006).

<sup>2</sup> *Id.*

<sup>3</sup> Fla. Stat. § 121.4501(4)(a) (2005).

<sup>4</sup> *Id.*

<sup>5</sup> Fla. Stat. § 121.4501(4)(e) (2005).

<sup>6</sup> Fla. Stat. § 121.021(17)(a) (2005) (“Creditable service means the sum of his or her past service, prior service, military service, out-of-state or non-FRS in-state service, workers’ compensation credit, leave-of-absence credit and future service allowed within the provisions of this chapter if all required contributions have been paid and all other requirements of this chapter have been met.”)

<sup>7</sup> Fla. Stat. § 121.021(24) (2005) (“Average final compensation means the average of the 5 highest fiscal years of compensation for creditable service prior to retirement, termination, or death.”)

<sup>8</sup> Fla. Stat. § 121.4501(3)(c)3. (2005).

<sup>9</sup> *Id.*

transfer the outstanding amount from the FRS Pension Plan to the participant's FRS Investment Plan account based upon eight percent annual interest, compounded annually.<sup>10</sup>

This bill changes the interest rate for transfers required due to insufficient funds from the FRS Pension Plan to the FRS Investment Plan. The bill sets the effective interest rate for the transfers "to the assumed return on the actuarial investment which was used in the most recent actuarial valuation of the system." Effective July 1, 2005, the actuarial investment return rate was reduced to 7.75% by the Florida Retirement System Actuarial Assumption Conference.

#### Credit for Military Service and the FRS Investment Plan

Part I of chapter 121, Florida Statutes, sets forth the general provisions for the FRS, including credit for military service in section 121.111, Florida Statutes. This section allows military service to be creditable service<sup>11</sup> for FRS purposes if five criteria are met:<sup>12</sup>

- (1) The employee is actively employed by an FRS employer immediately prior to service and leaves his or her employment for the purpose of induction into the Armed Forces of the United States or entry into active duty in the Armed Forces of the United States;<sup>13</sup>
- (2) The employee is entitled to reemployment under the provisions of the Veterans' Reemployment Rights Act;<sup>14</sup>
- (3) The employee applies for reemployment with the same FRS employer and is reemployed by that FRS employer within the applicable timeframes;<sup>15</sup>
- (4) The employee makes any required employee contributions and the employer makes the required employer contributions for the employee's membership class for each month of service credit during such period of military service;<sup>16</sup> and
- (5) The period of service claimed pursuant to this subsection does not exceed the applicable periods.<sup>17</sup>

Part II of chapter 121, Florida Statutes, relating to the FRS Investment Plan, is silent regarding credit for military service. This bill adds a provision to state that creditable service for FRS Investment Plan participants includes military service in the Armed Forces of the United States as provided in section 121.111, Florida Statutes.

#### Invalid Distributions and the FRS Investment Plan

Section 121.591, Florida Statutes, governs the payment of benefits under the FRS Investment Plan.

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<sup>10</sup> *Id.*

<sup>11</sup> Fla. Stat. § 121.021(17)(a) (2005), *supra* note 7.

<sup>12</sup> These criteria are provided in subsection (1). Subsection (2) applies to employees whose initial date of employment was before January 1, 1987, and it allows those employees to receive four years of creditable service for military service upon payment of certain contributions and subject to certain limitations.

<sup>13</sup> Fla. Stat. § 121.111(1)(a) (2005) (An employee is construed to have left his or her employment for military purposes if he or she reported for active duty within 60 days after leaving such employment).

<sup>14</sup> Fla. Stat. § 121.111(1)(b) (2005) (specifically citing "38 U.S.C. ss. 2021 et seq.")

<sup>15</sup> Fla. Stat. § 121.111(1)(c) (2005) (specifically citing "the time set forth in s. 2021 or s. 2024 of the Veterans' Reemployment Rights Act, whichever is applicable").

<sup>16</sup> Fla. Stat. § 121.111(1)(d) (2005) (based upon the employee's rate of monthly compensation as of the date that the employee left his or her position, plus 6.5 percent interest compounded annually).

<sup>17</sup> Fla. Stat. § 121.111(1)(e) (2005) (specifically citing "the provisions of ss. 2021 and 2024 of the Veterans' Reemployment Rights Act which are applicable in the member's case").

FRS Investment Plan payments also are controlled by section 121.4501, Florida Statutes, which establishes the FRS Investment Plan, and section 121.091(9), Florida Statutes, which provides limitations on employment after retirement.

In order for benefits to be paid, an employee must have terminated employment<sup>18</sup> with the FRS employer, or be deceased, and have filed an application to receive benefits. Benefit payments are not made until the employee has been terminated for three calendar months.<sup>19</sup> The State Board of Administration may permit, by rule, distribution of up to 10 percent of the participant's account after being terminated for one calendar month if a participant has reached the normal retirement requirements of the defined benefit plan.<sup>20</sup> Benefits are payable in one of three ways:

1. A lump-sum distribution to the participant;
2. A lump-sum direct rollover distribution where all accrued benefits, plus interest and investment earnings, are paid from the participant's FRS Investment Account directly to the custodian of an eligible retirement plan; or
3. Periodic distributions, as authorized by the State Board of Administration.<sup>21</sup>

This section does not currently have a provision which governs "invalid distributions."

This bill defines an invalid distribution as a distribution from an FRS Investment Account which violates the statute governing investment plan benefits,<sup>22</sup> the statute establishing the FRS Investment Account,<sup>23</sup> or the statute limiting employment after retirement.<sup>24</sup>

This bill provides that if an employee or former employee receives an "invalid distribution" from the Public Employee Optional Retirement Program Trust Fund, that invalid distribution must be repaid to the trust fund within 90 days after receipt of final notification by the State Board of Administration or the third-party administrator that the distribution was invalid. The bill further provides that if the employee or former employee does not repay the full invalid distribution within 90 days after receipt of final notification, the employee or former employee may be deemed to be retired from the FRS Investment Plan by the State Board of Administration and subject to section 121.122, Florida Statutes, which relates to renewed membership in the FRS. If an employee is deemed retired, the State Board of Administration, the Department of Management Services, or the employing agency are not liable for gains on payroll contributions that have not been deposited into the employee's FRS Investment Plan account pending resolution of the invalid distribution. The bill permits a member or former member who has been deemed retired or to have received an invalid distribution to appeal the agency decision.<sup>25</sup>

The changes are needed because of instances of investment plan members receiving distributions in error and failing to repay the amount despite repeated notifications of the error.<sup>26</sup> Many of these distributions involve members who received a distribution and then returned to work before the member was eligible by law.<sup>27</sup>

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<sup>18</sup> Fla. Stat. § 121.021(39) (2005).

<sup>19</sup> Fla. Stat. §§ 121.091(9)(c) and 121.591(1)(a)4. (2005) (created by ch. 2005-253, Laws of Fla.)

<sup>20</sup> Fla. Stat. § 121.591(1)(a)4. (2005).

<sup>21</sup> Fla. Stat. § 121.591(1)(c) (2005).

<sup>22</sup> Fla. Stat. § 121.591 (2005).

<sup>23</sup> Fla. Stat. § 121.4501 (2005).

<sup>24</sup> Fla. Stat. § 121.091(9) (2005).

<sup>25</sup> Fla. Stat. § 121.4501(9)(f)3. (2005) (requires the State Board of Administration to develop procedures to receive and resolve participant complaints against a provider or approved provider personnel, and, when appropriate, refer such complaints to the appropriate agency).

<sup>26</sup> Fla. State Board of Admin., Proposed 2006 Legislation (copy provided Jan. 2006) (on file with the State Board of Admin.) [hereinafter Fla. SBA Legislation 2006].

<sup>27</sup> Fla. SBA Legislation 2006.

## Authorized Investments: Generally

The investment of the funds in the Florida Retirement System Trust Fund is governed by the provisions in sections 215.44 through 215.53, Florida Statutes. Section 215.47, Florida Statutes, specifies the permissible investments for the FRS Pension Plan as well as for other funds.

## Authorized Investments: Without Limitation

There are currently 14 types of investments that the State Board of Administration is authorized to invest in without limitation.<sup>28</sup> Eight of these investments are bonds (or notes or other obligations) of identified governmental entities (e.g. the United States and the state). Of the six other investments, four relate to savings accounts and certificates of deposit, commercial paper, banker's acceptances, and negotiable certificates of deposit. Except for negotiable certificates of deposit, each of these investments must meet certain criteria:

- Investment in commercial paper must be "of prime quality of the highest letter and numerical rating as provided for by at least one nationally recognized rating service."<sup>29</sup>
- Investment in "savings accounts in, or certificates of deposit of, any bank, savings bank, or savings and loan association incorporated under the laws of this state or organized under the laws of the United States doing business and situated in this state, the accounts of which are insured by the Federal Government or an agency thereof" is limited to 15 percent of the net worth of the institution or a lesser amount if provided by a rule of the State Board of Administration.<sup>30</sup>
- Investments in time drafts or bills of exchange (banker's acceptances) must be accepted by a member bank of the Federal Reserve System having total deposits not less than \$400 million.<sup>31</sup>

There currently are no criteria for negotiable certificates of deposit issued by domestic or foreign financial institutions in United States dollars.<sup>32</sup>

The bill eliminates the net worth requirement for savings accounts and certificates of deposit and the deposit requirement for banker's acceptances. In its place, the bill applies criteria similar to that used for used for commercial paper of requiring the investment to have a "prime quality of the highest letter and numerical rating as provided by at least one nationally recognized statistical rating organization".

Although not defined in the bill, a nationally recognized statistical rating organization ("NRSROs") is an organization that has been identified by the United States Securities and Exchange Commission.<sup>33</sup> There are currently five NRSROs: A.M. Best Company, Inc. ("A.M. Best"), Dominion Bond Rating Service Limited ("DBRS"); Fitch, Inc. ("Fitch"); Moody's Investors Service Inc. ("Moody's"); and the Standard & Poor's Division of the McGraw Hill Companies, Inc. ("S&P").<sup>34</sup>

Each of these NRSROs has its own set of credit ratings. For example, Moody's long-term issue credit ratings<sup>35</sup> range from Aaa<sup>36</sup> to C<sup>37</sup> and Moody's "appends numerical modifiers to each generic rating

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<sup>28</sup> Fla. Stat. § 215.47(1) (2005).

<sup>29</sup> Fla. Stat. § 215.47(1)(j) (2005).

<sup>30</sup> Fla. Stat. § 215.47(1)(h) (2005).

<sup>31</sup> Fla. Stat. § 215.47(1)(k) (2005).

<sup>32</sup> Fla. Stat. § 215.47(1)(l) (2005).

<sup>33</sup> The Securities and Exchange Commission has never defined the term NRSRO. Instead, NRSROs are identified through the no-action letter process. Securities and Exchange Commission, Release No. 33-8570, Definition of Nationally Recognized Statistical Rating Organization (Apr. 19, 2005), available at <http://www.sec.gov/rules/proposed/33-8570.pdf> (last visited Mar. 11, 2006).

<sup>34</sup> *Id.*

<sup>35</sup> Moody's, Long-Term Obligation Ratings, available at <http://www.moody.com/moodys/cust/AboutMoody/AboutMoody.aspx?topic=rdef&subtopic=moodys%20credit%20ratings&title=Long+Term+Obligation+Ratings.htm> (last visited Mar. 11, 2006; free login required).

<sup>36</sup> *Id.* ("Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.")

classification from Aa to Caa.”<sup>38</sup> By contrast, S&P long-term issue credit ratings<sup>39</sup> range from AAA<sup>40</sup> to D<sup>41</sup> and “may be modified by the addition of a plus or minus sign to show relative standing within the major categories.”<sup>42</sup>

The State Board of Administration supports<sup>43</sup> changing the criteria for savings accounts,<sup>44</sup> certificates of deposit,<sup>45</sup> banker’s acceptances,<sup>46</sup> and negotiable certificates of deposit.

**Authorized Investments: No More than 25 Percent**

There are currently 11 types of investments that the State Board of Administration is authorized to invest in “with no more than 25 percent of any fund.”<sup>47</sup> Most of these “25-percent-authorized investments” also must meet certain criteria. The bill changes some of these criteria and eliminates specific authority related to one of the authorized investments.

*Municipal/Political Subdivision Bonds, Notes, or Obligations.* Currently, the State Board of Administration may invest in bonds, notes, or obligations of any municipality or political subdivision or any agency or authority of the state as long as those obligations are rated in any one of the three highest ratings by two nationally recognized rating services.<sup>48</sup> If only one nationally recognized rating service has rated the obligation, the rating must be in one of the two highest classifications.<sup>49</sup> This bill lowers the required rating to “investment grade” by at least one nationally recognized statistical rating organization. The following table illustrates the permissible investment range under current law and under the bill:

Source	Requirement	S&P	Moody’s
Current Law	Three Highest Ratings	AAA, AA, A	Aaa, Aa1, Aa2
Current Law	Two Highest Ratings	AAA, AA	Aaa, Aa1
Bill	Investment Grade	AAA, AA, A, <u>BBB</u>	Aaa, Aa1, Aa2, <u>Aa3, A1, A2, A3, Baa1, Baa2, Baa3</u>

The State Board of Administration characterizes this change as a matter of consistency with the investment grade criteria for investing in fixed-income obligations<sup>50</sup> issued by foreign governments or

<sup>37</sup> *Id.* (“Obligations rated C are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.”)

<sup>38</sup> *Id.*

<sup>39</sup> S&P, Long-term issue credit ratings, available at <http://www2.standardandpoors.com/servlet/Satellite?pagename=sp%2FPPage%2FSiteSearchResultsPg&I=EN&r=1&b=10&search=site&vqt=%22long-term+issue+credit+ratings%22#FixedIncome> (click on “Long-term Issue Credit Ratings” in results, last visited Mar. 11, 2006).

<sup>40</sup> *Id.* (“An obligation rated ‘AAA’ has the highest rating assigned by S&P and the obligor’s capacity to meet its financial commitment on the obligation is extremely strong.”)

<sup>41</sup> *Id.* (“An obligation rated ‘D’ is in payment default. The ‘D’ rating category is used when payments on an obligation are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor’s believes that such payments will be made during such grace period. The ‘D’ rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.”)

<sup>42</sup> *Id.*

<sup>43</sup> The State Board of Administration approved this general legislative proposal at its meeting on December 13, 2005. Fla. State Board of Admin., Transcript, Fla. Cabinet Meeting, Dec. 13, 2005, pp. 52-53, Item 4. (Dec. 21, 2005).

<sup>44</sup> The State Board of Administration indicates the current credit exposure limitation is redundant under current portfolio guidelines and is rarely used in their portfolios. The State Board of Administration also indicates that “automated compliance testing is not possible...due to net worth information not being available.” Fla. SBA Legislation 2006.

<sup>45</sup> *Id.*

<sup>46</sup> According to the State Board of Administration, “these types of securities have diminished in importance and are also rarely used in their portfolios.” It also is another area where automated compliance testing with the deposit size requirement is difficult because this information is not available. The State Board of Administration believes these changes better reflect credit quality and are more effective and efficient. Fla. SBA Legislation 2006.

<sup>47</sup> Fla. Stat. § 215.47(2) (2005).

<sup>48</sup> Fla. Stat. § 215.47(2)(a) (2005).

<sup>49</sup> *Id.*

<sup>50</sup> Fla. Stat. § 215.47(2)(g) (2005).

political subdivisions or agencies thereof, supranational agencies, foreign corporations, or foreign commercial entities.<sup>51</sup>

*Certain Notes Secured by First Mortgages.* The State Board of Administration is authorized to invest in notes secured by first mortgages on Florida real property that are insured or guaranteed by the Federal Housing Administration or the United States Department of Veterans Affairs.<sup>52</sup> The bill removes the limitation to Florida real property. According to the State Board of Administration, first mortgages pooled in Federal Housing Administration and Department of Veterans Affairs certificates are not pooled by the state.<sup>53</sup> As such, the State Board of Administration cannot utilize this provision unless it is expanded.

*Investments Collateralized by Certain First Mortgages.* The State Board of Administration is authorized to invest in investments that are collateralized by first mortgages covering single-family Florida residences which meet certain criteria: do not exceed \$60,000, do not exceed 80 percent of value, are not delinquent, and are originated by a lender regulated by the state or Federal Government.<sup>54</sup> The aggregate collateral furnished by the mortgage must be at least 150 percent of the aggregate investment and the mortgages must be segregated by the lending institution.<sup>55</sup> If one of these mortgages becomes more than three months delinquent, the lender is required to substitute a mortgage of equal or greater value.<sup>56</sup> Because the State Board of Administration considers these provisions “dated, limited in scope, and redundant,”<sup>57</sup> the bill removes this specific authority. The State Board of Administration will, however, continue to have the authority to invest in these mortgages under another provision of this section<sup>58</sup> which authorizes investment in other asset backed securities.<sup>59</sup>

*Certain Group Annuity Contracts.* The State Board of Administration is authorized to invest in group annuity contracts of the pension investment type with insurers licensed to do business in this state provided that the amount invested with any one insurer does not exceed three percent of its assets.<sup>60</sup> This bill removes the asset-percentage limitation and replaces it with the following requirement: rated investment grade by at least one nationally recognized rating service. The State Board of Administration views the “asset limitation as an attempt to impose credit limits, which are better effectuated by using rating requirements.”<sup>61</sup> The State Board of Administration cites consistency with the other changes in the bill and the investment grade standard for investing in fixed-income obligations<sup>62</sup> issued by foreign governments or political subdivisions or agencies thereof, supranational agencies, foreign corporations, or foreign commercial entities as support the investment grade level for these investments.<sup>63</sup>

#### Authorized Investments: Certain Foreign Corporations or Foreign Commercial Entities

The State Board of Administration is authorized to invest no more than 20 percent of any fund in corporate obligations and securities of any kind of a foreign corporation or a foreign commercial entity which has its principal office located in any country other than the United States of America or its possessions or territories.<sup>64</sup> This authority does not include United States dollar-denominated

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<sup>51</sup> Fla. SBA Legislation 2006.

<sup>52</sup> Fla. Stat. § 215.47(2)(b) (2005).

<sup>53</sup> Fla. SBA Legislation 2006.

<sup>54</sup> Fla. Stat. § 215.47(2)(c) (2005).

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> Fla. SBA Legislation 2006.

<sup>58</sup> Fla. Stat. § 215.47(2)(k) (2005).

<sup>59</sup> *Id.*

<sup>60</sup> Fla. Stat. § 215.47(2)(e) (2005).

<sup>61</sup> Fla. SBA Legislation 2006.

<sup>62</sup> Fla. Stat. § 215.47(2)(g) (2005).

<sup>63</sup> Fla. SBA Legislation 2006.

<sup>64</sup> Fla. Stat. §215.47(5) (2005).

securities listed and traded on a United States exchange which are a part of the ordinary investment strategy of the board.<sup>65</sup> The bill increases the authorized percentage from 20 percent to 25 percent.

The State Board of Administration explains the necessity for this change:

“This will help avoid cross-over investments topping the current 20 percent limit. The majority of the world’s investment opportunities lie outside the United States, with many of the leading multinational companies now being based outside the United States. International investing expands opportunities to invest in different types of industries that might not be prevalent in the United States. Asset classes that typically have not invested outside the United States are beginning to expand their strategies to include Foreign Markets. As the Real Estate and Alternative Asset Classes explore and begin to invest globally, we will easily reach our 20 percent ceiling on international investing and possibly miss opportunities for future asset growth.”<sup>66</sup>

#### Authorized Investments: Selling Short

The bill authorizes the State Board of Administration to “sell short” any authorized securities and investments:

“A short sale is generally the sale of a stock you do not own. Investors who sell short believe the price of the stock will fall. If the price drops, you can buy the stock at the lower price and make a profit. If the price of the stock rises and you buy it back later at the higher price, you will incur a loss. When you sell short, your brokerage firm loans you the stock. The stock you borrow comes from either the firm’s own inventory, the margin account of another of the firm’s clients, or another brokerage firm. As with buying stock on margin, your brokerage firm will charge you interest on the loan, and you are subject to the margin rules. If the stock you borrow pays a dividend, you must pay the dividend to the person or firm making the loan.”<sup>67</sup>

The State Board of Administration explains the necessity for this change:

“Current law allows the State Board of Administration to buy and sell futures contracts,<sup>68</sup> options,<sup>69</sup> and notional principal contracts.<sup>70</sup> Under current law, the smallest position a long-only portfolio can hold is zero, limiting the portfolio manager’s ability to express negative views on stocks with small index weights. Conversely, the ability to profit from positive views by overweighting stocks is allowed within the parameters of the manager’s investment guidelines. The inability of long-only portfolio managers to capture the added value associated with correctly identifying poorly performing stocks suggest that value added opportunities are not being fully explored. Large institutional investors are beginning to implement programs that combine a group of market-neutral equity managers to overlay equity index futures. The objective is to outperform the passive equity index. This approach allows institutional investors

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<sup>65</sup> *Id.*

<sup>66</sup> Fla. SBA Legislation 2006.

<sup>67</sup> United States Sec. and Exch. Comm., *Short Sales*, available at <http://www.sec.gov/answers/shortsale.htm> (last visited Mar. 12, 2006).

<sup>68</sup> “A futures contract is an agreement to buy or sell a specific quantity of a commodity or financial instrument at a specified price on a particular date in the future. Commodities include bulk goods, such as grains, metals, and foods, and financial instruments include U.S. and foreign currencies.” United States Sec. and Exch. Comm., *Commodity Futures Trading Commission*, available at <http://www.sec.gov/answers/cftc.htm> (last visited Mar. 12, 2006).

<sup>69</sup> “Options are contracts giving the purchaser the right to buy or sell a security, such as stocks, at a fixed price within a specific period of time.” United States Sec. and Exch. Comm., *Options Trading*, available at <http://www.sec.gov/answers/options.htm> (last visited Mar. 12, 2006).

<sup>70</sup> “A notional principal contract is a financial instrument that provides for the payment of amounts by one party to another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts.” Notional Principal Contracts, 26 C.F.R. § 1.446-3 (2006), available at <http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=8ddaf18a7b848e2e65251a98c9274c05;rgn=div8;view=text;node=26%3A6.0.1.1.1.0.4.16;idno=26;cc=ecfr> (last visited Mar. 12, 2006).



to take advantage of both long and short positions in their effort to add value over the passive equity index. This approach has a number of benefits relative to other programs that utilize alternative types of investments. These benefits include complete transparency, daily valuation, higher levels of diversification and risk control, lower fees, and a simple institutional investment structure.”<sup>71</sup>

### Changing a Cross Reference

The bill also changes a cross reference in section 1002.36(4)(e)14., Florida Statutes, relating to the investment authority of the Board of Trustees for the Florida School of the Deaf and Blind.

#### C. SECTION DIRECTORY:

- Section 1: Amends section 121.4501, Florida Statutes, to revise the interest rate calculation for transfers between retirement plans and to provide credit for military service for members of the FRS Investment Plan.
- Section 2: Amends section 121.591, Florida Statutes, to create procedures pertaining to invalid distributions from the FRS Investment Plan.
- Section 3: Amends section 215.47, Florida Statutes, to revise the standards for investments by the State Board of Administration.
- Section 4: Amends section 1002.36, Florida Statutes, to update a cross reference.
- Section 5: Provides an effective date of July 1, 2006.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

##### 1. Revenues:

The bill does not appear to directly create, modify, amend, or eliminate any revenues of state government, but is expected to have a positive fiscal impact on the funds managed by the State Board of Administration.

##### 2. Expenditures:

This bill does not appear to create, modify, amend, or eliminate any expenditures of state government.

#### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

##### 1. Revenues:

This bill does not appear to create, modify, amend, or eliminate any revenues of local governments.

##### 2. Expenditures:

This bill does not appear to create, modify, amend, or eliminate any expenditures of local government.

#### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

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<sup>71</sup> Fla. SBA Legislation 2006.

This bill may have a direct impact on the private sector through the revised investment authority provided to the State Board of Administration.

D. FISCAL COMMENTS:

This bill may have a positive fiscal impact on the funds managed by the State Board of Administration.

**III. COMMENTS**

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not appear to require counties or municipalities to spend funds or to take an action requiring the expenditure of funds. This bill does not appear to reduce the percentage of a state tax shared with counties or municipalities. This bill does not appear to reduce the authority that counties or municipalities have to raise revenue.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill does not appear to create, modify, or eliminate rulemaking authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**

None.