



## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### Background

##### State Board of Administration

The State Board of Administration (SBA or Board) is established by Article IV, Section 4(e) of the Florida Constitution and is composed of the Governor as chair, the Chief Financial Officer and the Attorney General. The Board members commonly are referred to as "Trustees."

The powers and duties of the Board include the management of 36 separate statutory investment portfolios, the largest one of which is the multi-employer Florida Retirement System (FRS).<sup>1</sup> Since 2002, the FRS has offered two types of retirement plans:

- A defined benefit, or percent of final pay ("Pension") plan with a guaranteed annuitized benefit at retirement, and
- A defined contribution ("Investment") plan in which assets are self-directed by the participant.

Participating public employers make all payroll contributions with no employee participation or cost sharing. The Board manages the assets of both plans but benefit payments in the Pension Plan are the responsibility of the Division of Retirement in the Department of Management Services.

The SBA also appoints an Investment Advisory Council to review investments and make recommendations to the Trustees regarding investment policy, strategy and procedures.<sup>2</sup> The council currently consists of six members, appointed to a four year term, who must be confirmed by the Senate.

Administratively, the SBA is managed by an executive director who is hired by the Trustees. The Trustees determine the qualifications for the position of executive director.

##### The Public Employee Optional Retirement Program

The Public Employee Optional Retirement Program (FRS Investment Plan) is a voluntary alternative retirement plan to the FRS Pension Plan.<sup>3</sup> It offers participants a range of individually allocated or

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<sup>1</sup> Section 215.44, F.S.

<sup>2</sup> Section 215.444(1), F.S.

<sup>3</sup> Section 121.4501, F.S.

unallocated investment products modeled after private sector 401(k) plans. The FRS Investment Plan enables members to play an active role in selecting and managing their retirement benefits through a diverse set of 20 investment options, including three balanced funds. Fees for the investment offerings range from .02 percent to .93 percent. As of December, 31, 2009, the Investment Plan had 122,769 active accounts and \$4.8 billion in assets.<sup>4</sup>

Currently, all new employees hired with an FRS-covered employer are enrolled in the FRS Pension Plan upon employment. New employees have until 4:00 p.m. eastern time of the last business day of the fifth month following their month of hire to elect membership in the FRS Investment Plan. If they fail to elect membership in the plan by the designated choice end date, the member is defaulted into the FRS Pension Plan.<sup>5</sup>

After their initial election, all FRS members have a one-time 2nd election to switch retirement plans so long as they are working and earning retirement service credit.<sup>6</sup> The member must submit a 2nd election enrollment form that must be received by the Plan Choice Administrator prior to their employment termination date. The plan change is effective the first day of the month following receipt of the enrollment form by the Plan Choice Administrator.<sup>7</sup>

Some members of the FRS Investment Plan currently have excess account balances.<sup>8</sup> Distributions of those excess account balances prior to retirement could violate Internal Revenue Service regulations regarding in-service distributions.

#### FRS Investment Plan Dispute Process

Issues between participants of the FRS Investment Plan and the third-party administrator or providers of investment products are handled through a dispute process.<sup>9</sup> There currently is no process to handle disputes between FRS Investment Plan participants and the program itself. Additionally, there is no third-party records retention requirement to insure the availability of the information in the event a participant files a complaint. A retention requirement is important in order to insure that all records are transferred to the new vendor when there is a change of vendors.

#### The FRS Pension Plan

The State Board of Administration is responsible for the investment of the FRS Pension Plan assets. In doing so, it must follow the Florida Statutes' fiduciary standards of care, subject to certain limitations. A six-member Investment Advisory Council provides independent oversight of the FRS Pension Plan's general objectives, policies and strategies. The SBA's ability to invest the FRS assets is governed by section 215.47, Florida Statutes, which provides a "legal list" of the types of investments and for how much of the total fund may be invested in each investment type.<sup>10</sup> One of the guidelines is that no more than 25 percent of the FRS Pension Plan's assets can be invested in foreign securities.

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<sup>4</sup> State Board of Administration HB 1307 (2010) Substantive Bill Analysis (March 17, 2010) at 1 (on file with the Governmental Affairs Policy Committee).

<sup>5</sup> Section 121.4501(4), F.S.; Rule 19-11.006(3), F.A.C.

<sup>6</sup> Section 121.4501(4)(e), F.S.

<sup>7</sup> Rule 19-11.007, F.A.C.

<sup>8</sup> As of January 15, 2010, 1338 FRS Investment Plan participants had excess account balances.

<sup>9</sup> Rule 19-11.005, F.A.C.

<sup>10</sup> Section 215.47, F.S., provides the "legal list" of types of investments summarized as follows:

- No more than 80 percent of assets can be invested in domestic common stocks.
- No more than 75 percent of assets can be invested in internally managed common stocks.
- No more than 3 percent of equity assets can 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 5 percent of any fund should be invested in private equity through participation in limited partnerships and limited liability companies.

## Effect of Proposed Changes

This bill includes changes to the FRS Investment Plan that codify practices and policies being used in administration of the plan since its inception. It makes changes to the investment authorizations for the FRS Pension Plan by increasing the permitted holdings for foreign equity from 25 percent to 35 percent of the total fund. The bill also permits proceeds of bonds issued on behalf of the Florida Hurricane Catastrophe Fund (CAT Fund) to be invested without limitation in certain federal tax-exempt obligations. The SBA believes that this additional flexibility is necessary to meet changing market conditions.

The bill permits the SBA executive director to extend an expiration of moratoriums on contributions and withdrawals to the Local Government Investment Pool in cases where an emergency meeting of the Trustees of the SBA cannot be convened within the current 48 hour moratorium window.

The bill also provides FRS Investment Plan administrative rate reductions. Effective July 1, 2010, the employer contribution rate is reduced from 0.05 percent to 0.03 percent. The contribution increases to 0.04 percent effective July 1, 2014. It is anticipated that these rate changes will reduce the balance of the Investment Plan Trust Fund over the next four years to achieve approximately a one-year surplus in the fund.<sup>11</sup> The Investment Plan Trust Fund balance was approximately \$34 million as of July 1, 2009.<sup>12</sup> The projections on the proposed rate reduction would leave the Trust Fund at approximately \$18 million in 2014. It is anticipated that a 0.04 percent contribution rate would carry the plan for several years after 2014.

Additional time is provided in the bill for FRS employers to pay invoices for member losses. The current 10 day limitation is expanded to 30 days to coincide with monthly payroll practices. Should an Act of God or other force majeure event prevent the posting of an employer contribution to a participant's account any market losses are not payable to such participant.

The bill authorizes the SBA to secure trademarks, copyrights, and patents on behalf of the FRS or any other fund under its jurisdiction.

The bill also clarifies that the SBA is authorized to purchase taxable and tax-exempt municipal bonds issued by any state or local entity without limit if they are backed by the full faith and credit of the issuing entity. Additionally, the SBA has express authority to invest up to 25 percent of any fund in taxable and tax-exempt municipal bonds if the state or local issuing entity is rated investment grade. Both changes permit the SBA to purchase Build America Bonds.

The bill permits the SBA to invest in Qualified School Bonds and revenue bonds issued by states that are secured by the full faith and credit of the state. The SBA also is authorized to invest the proceeds of bonds issued on behalf of the Florida Hurricane Catastrophe Fund to certain federal tax-exempt obligations to the extent required to comply with covenants relating to such bonds.

Finally, the bill addresses governance changes to the SBA. It requires the Board to produce annual financial statements as reported by an independent audit firm, requires minimum qualifications for the executive director, increases the number of members on the Investment Advisory Council from six to nine, and provides for transparency and accountability of the Board through implementing policies, guidelines and procedures.

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- No more than 25 percent of assets can be invested in foreign securities.

<sup>11</sup> Projections on reductions are contingent on budget projections holding over the next four years and no unpredicted changes in the Forfeiture Account patterns or other Legislative actions that might affect Investment Plan operations.

<sup>12</sup> State Board of Administration HB 1307 (2010) Substantive Bill Analysis (March 17, 2010) at 3 (on file with the Governmental Affairs Policy Committee).

**B. SECTION DIRECTORY:**

**Section 1.** Amends section 121.4501, F.S., to revise and provide definitions, to provide for use of excess account balances in the FRS Investment Plan, to require the SBA to develop procedures to resolve complaints, and to clarify the rulemaking authority of the Board.

**Section 2.** Amends section 121.4502, F.S., to establish a forfeiture account in the Public Employee Optional Retirement Program Trust Fund.

**Section 3.** Amends section 121.591, F.S., to authorize an application for benefits under the FRS Investment Plan to be submitted by electronic means.

**Section 4.** Amends section 121.74, F.S., to revise employer contribution rates.

**Section 5.** Amends section 121.78, F.S., to exempt the Division of Retirement, SBA, and the third-party administrator from liability for market losses due to acts of God.

**Section 6.** Amends section 215.44, F.S., to provide reporting requirements for the SBA.

**Section 7.** Amends section 215.441, F.S., to provide for minimum qualifications for the executive director of the SBA.

**Section 8.** Amends section 215.444, F.S., to increase membership and to revise the membership requirements of the Investment Advisory Council.

**Section 9.** Amends section 215.47, F.S., to expand the types of investments the SBA is authorized to make and to permit proceeds of bonds issued on behalf of the Florida Hurricane Catastrophe Fund to be invested, without limitation, in specified federal tax-exempt obligations. The asset allocation in foreign equities is increased from 25 to 35 percent of the total fund.

**Section 10.** Amends section 215.52, F.S., to revise the rule making authority of the SBA.

**Section 11.** Amends section 218.409, F.S., to permit the SBA executive director to extend the expiration of moratoriums on contributions and withdrawals to the Local Government Investment Pool in the event the trustees cannot convene an emergency meeting.

**Section 12.** Permits the SBA to secure and enforce letters of patent, copyrights, and trademarks on any work products developed by or for the SBA.

**Section 13.** Provides for an effective date of July 1, 2010.

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

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

1. Revenues:

<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u> <sup>13</sup>
None	None	None

<sup>13</sup> State Board of Administration HB 1307 (2010) Substantive Bill Analysis (March 17, 2010) at 5 (on file with the Governmental Affairs Policy Committee) and subsequent correspondence with SBA staff.

2. Expenditures: from the reduction of the administration contribution from .05 to .03 percent.

<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13<sup>14</sup></u>
(\$4.2m)	(\$4.2m)	(\$4.2m)

Note: based on the state's practice of funding increases or decreases associated with employer retiree contribution rates to universities, community colleges and county school boards.

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

1. Revenues:

None.

2. Expenditures: from the reduction of the administration contribution from .05 to .03 percent.

<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13<sup>15</sup></u>
(\$2.2m)	(\$2.2m)	(\$2.2m)

Note: includes counties, participating municipalities and special districts.

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

Insignificant.

**D. FISCAL COMMENTS:**

The reduction from 0.05 percent to 0.03 percent will result in a savings of \$6,360,000 annually, thus allowing the drawdown of surplus funds. The savings would be passed on to FRS employers.<sup>16</sup>

Additionally, there will be some minimal increases in costs for the Investment Advisory Council by adding three new members.

**III. COMMENTS**

**A. CONSTITUTIONAL ISSUES:**

1. Applicability of Municipality/County Mandates Provision:

The bill does not appear to: require cities or counties to spend funds or take an action requiring the expenditure of funds; reduce the authority that cities or counties have to raise revenues in the aggregate; or reduce the percentage of a shared state tax or premium sales tax received by cities or counties.

2. Other:

None.

**B. RULE-MAKING AUTHORITY:**

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

The bill clarifies the scope of the SBA's rule making authority with regard to administering the FRS Investment Plan. Rules must provide for transparency and accountability regarding the board's fiduciary duties.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES**

On March 10, 2010, the Governmental Affairs Policy Committee adopted three amendments and reported HB 1307 favorably with committee substitute. The amendments tightened the rulemaking authority provided in the bill and authorized the SBA to:

- Purchase specified municipal bonds with up to 25 percent of any fund;
- Invest in Qualified School Bonds and revenue bonds issued by states secured by the full faith and credit of the state; and
- Invest proceeds of hurricane "CAT Fund" bonds in certain federal tax-exempt obligations.