

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 Community Affairs Committee

BILL: CS/CS/SB 2186

INTRODUCER: Community Affairs Committee, Governmental Oversight and Accountability Committee, and Senator Ring

SUBJECT: The State Board of Administration

DATE: March 23, 2010 **REVISED:** _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Wilson</u>	<u>Wilson</u>	<u>GO</u>	<u>Fav/CS</u>
2.	<u>Wolfgang</u>	<u>Yeatman</u>	<u>CA</u>	<u>Fav/CS</u>
3.	_____	_____	<u>WPSC</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

Please see Section VIII. for Additional Information:	
A. COMMITTEE SUBSTITUTE.....	<input checked="" type="checkbox"/> Statement of Substantial Changes
B. AMENDMENTS.....	<input type="checkbox"/> Technical amendments were recommended
	<input type="checkbox"/> Amendments were recommended
	<input type="checkbox"/> Significant amendments were recommended

I. Summary:

The committee substitute (CS) revises the operating practices of the Board of Administration to provide additional audit services, periodic training in fiduciary duty matters, and to specify ethics standards for investment managers and financial advisers under contract to the board. It prescribes additional duties and qualifications for these members and the executive director of the board.

This CS substantially amends ss. 121.4501, 215.44, 215.441, 215.442, 215.444, 215.47, 215.475, and 215.52, of the Florida Statutes.

The CS also creates ss. 215.4754, 215.443, and 215.4755, F.S.

II. Present Situation:

The Public Employee Optional Retirement Program

The Florida Retirement System (FRS) is composed of two programs: The Defined Benefit Program (FRS Pension Plan) and the Defined Contribution Program (FRS Investment Plan),

properly known as the Public Employee Optional Retirement Program (PEORP). The term ‘defined contribution’ for the FRS Investment Plan means that employer *contributions* are defined; whereas in the FRS Pension Plan, the *benefit* is defined.¹

The FRS Investment Plan shifts the investment risks from the employer to the employee by allowing the individual employee to select and manage their own investment options- similar to private 401(k) plans. Unlike the Pension Plan, benefits under the Investment Plan vest after only one year of service and are portable to other employer’s plan or private 401(k) plans. Since the value of employee benefits under the Investment Plan are subject to changes in the market, improper planning or poor market performance can cause some employees to outlive their benefits. Employees under the FRS Investment Plan are not eligible to participate in the Deferred Retirement Option Program (DROP) and cannot receive a Health Insurance Subsidy (HIS) until they reach the age of 62 (55 for Special Risk members).²

The FRS is administered by two state agencies: The Department of Management Services and the State Board of Administration. The Department of Management Services’ Division of Retirement provides administrative services which include: recording membership enrollments, receiving employer contributions, monitoring the trust fund, calculating retirement benefits, and publishing the annual actuarial report. The State Board of Administration³ is primarily responsible for overseeing and investing FRS pension benefits to ensure sufficient investment returns and administering and approving programs under the FRS Investment Plan. Both agencies monitor the MyFRS Financial Guidance Program and retirement plan educational programs.

The State Board of Administration

The State Board of Administration (SBA) is comprised of the Governor, Chief Financial Officer and Attorney General.⁴ The SBA manages thirty-six separate statutory investment portfolios, the largest one of which is the multi-employer Florida Retirement System. The SBA must invest and reinvest available funds of the System Trust Fund in accordance with the specified statutory provisions.⁵ The System Trust Fund is the trust fund established by statute in the State Treasury for the purpose of holding and investing the contributions paid by members and employers and paying the benefits to which members or their beneficiaries may become entitled.⁶ Other trust funds may be established in the State Treasury to administer the System Trust Fund. In making investments for the System Trust Fund the board may not make any investments not in conformance with the Florida Retirement System Defined Benefit Plan Investment Policy Statement.⁷

¹ MyFRS FRS INVESTMENT PLAN SUMMARY PLAN DESCRIPTION, (July 1, 2009) *available at* http://www.myfrs.com/imageserver/pdf/forms/frs_ip_spd.pdf (last visited on Feb. 24, 2010) [emphasis added].

² MyFRS, PLAN COMPARISON CHARTS: THE FRS INVESTMENT PLAN, *available at* http://www.myfrs.com/portal/server.pt/community/comparing_the_plans/235 (last visited on Feb. 24, 2010).

³ The State Board of Administration consists of the Governor, the Chief Financial Officer, and the Attorney General. *See* Florida State Board of Administration (SBA), *available at* <http://www.sbafla.com/fsb/> (last visited on March 1, 2010).

⁴ Section 16, art. IX, Constitution of 1885, and continued by s. 9, art. IX, State Constitution, as revised in 1968 and subsequently amended.

⁵ Section 121.151, F.S.

⁶ Section 121.021(36), F.S.

⁷ Section 215.475(1), F.S.

The SBA also manages investments on behalf of the Hurricane Catastrophe Fund, the Florida Lottery, the Pre-Paid College Fund, its own separately constituted Division of Bond Finance, and pooled money market funds for local governments (Florida Prime), among others. Assets under management on March 4, 2010, totaled \$139 billion.

The Trustees and agency investment personnel are named fiduciaries for the management of funds under their control. As such, they must adhere to the duties of prudence, loyalty, sole and exclusive benefit in the discharge of their responsibilities. The SBA also houses a statutory Investment Advisory Council whose purpose is to provide the staff and Trustees with non-fiduciary advice on trends and conditions in the institutional investment marketplace. The SBA participates with its peer plans in a number of institutional investor organizations on matters affecting national and international finance.

Since the congressional passage of the Sarbanes-Oxley Act of 2002, Pub.L. 107-204, increased attention has been devoted toward the duties of auditors and fiduciaries in general. Successive changes to world financial markets beginning in late 2007 only accelerated the scrutiny devoted to institutional financial organizations in both public and private sectors. At that time the SBA's Local Government Investment Pool, since renamed Florida Prime, experienced a wave of redemptions by subscribing local governments. A number of the financial instruments contained in this money-market pool were commercial paper, collateralized mortgage obligations, and collateralized debt obligations. They were rated as investment grade at the time of purchase but their components, that is, the separate mortgages and debt securities, rapidly declined in value due to an overleveraged market. The pace of the redemptions saw the fund balance fall from \$26.2 billion in October 2007 to \$9.8 billion only two months later as liquidity concerns gripped its members. At the end of January 2010, the fund balance was \$6.3 billion. Subsequent reviews of the circumstances affecting this loss of liquidity led the 2008 Legislature to create a separate advisory structure for the pooled funds. An investigation of these circumstances was also undertaken by the Securities and Exchange Commission and on March 3, 2010, that federal agency closed the investigative file with no action indicated.

In response to the above series of events the SBA staff commissioned a review of its organizational configuration and investment controls. That report, Governance Research Project, was issued on September 9, 2009, and compared and contrasted the SBA's structure and professional competencies among a peer group of ten state-level institutional pension plans. The specific dimensions analyzed were board composition, pension and non-pension mandates, selection of investment managers, budget approval, governance structure, and meeting frequency. In the period since the release of the report two of the SBA Trustees have separately made recommendations for statutory changes in the areas of board and investment advisory composition and meeting frequency. Both trustees have indicated in separate communications that an enhanced internal and external audit commitment would be welcome.

III. Effect of Proposed Changes:

Section 1. The CS amends s. 121.4501, F.S., to specify that it is the executive director of the state board who develops the policy statement for the Public Employee Optional Retirement Program. The bill provides for the prior approval by the Investment Advisory Council of the Investment Policy Statement issued to the SBA.

Section 2. Section 215.44, F.S., is amended to make nomenclature changes and to require that the SBA maintain a salary and benefit structure for its employees consistent with that contained in s. 110.205, F.S., and exempt from the Career Service System. The Investment Advisory Council is directed to hire a private consulting firm to conduct such compensation studies as may be required, not less often than every five years, to establish competitive total compensation. The section establishes an audit committee to direct the efforts of the board's auditors and prescribes the appointments for the designated members. The auditing committee shall consist of 3 members that are each appointed for 4-year terms. The auditing committee directs external auditors and internal auditing staff to report to the executive director of the state board and the board itself. Each year the board shall produce financial statements for the Florida Retirement System for the Legislature and a commercial independent third-party audit firm. The board shall meet at least quarterly and shall receive reports from the: audit committee, investment advisory committee, inspector general, general counsel, executive director, and others.

Section 3. Section 215.441, F.S., is amended to prescribe specific qualifications for the SBA's executive director which shall include relevant experience in the institutional management of fiduciary funds. The board shall appoint a search committee before the appointment of an executive director, whose salary shall be set by the board.

Section 4. Section 215.442, F.S., is amended to include the Investment Advisory Council as a recipient of quarterly reports on downgraded securities and to affirm its role as a resource to the plan trustees.

Section 5. Section 215.443, F.S., is created to create the Agency for Professional Fund Management and provide for its makeup. On January 1, 2011, the agency will be created within the State Board of Administration. There will be 5 members appointed by the board and subject to confirmation by the Senate. The members shall elect a chair each year from their membership. Members shall:

- meet at least every other month (except if the chair calls an emergency meeting);
- receive no compensation;
- serve 4-year terms;
- may be suspended or removed for cause by the board;
- are fiduciaries;
- shall file financial disclosures;
- be professionally distinguished with at least 5 years of financial management experience;
- be in good standing within their profession;
- oversee investment decisions by the board.

Decisions made by the agency may be altered only by unanimous vote of all three members of the board in a public meeting.

Section 6. Section 215.444, F.S., is amended to require the Investment Advisory Council to meet with staff of the board and provide a quarterly report to the trustees. The CS revises the experience and training requirements of the Council members. Sovereign immunity waivers that

apply to the torts of government employees under s. 768.28, F.S., apply to Council members.⁸ Any council recommendations must be based upon fiduciary standards. The Council will also approve subsequent Investment Policy Statements, participate in the selection process for the executive director, engage in compensation studies, and provide recommendations. The Council will meet quarterly to review the performance of investments. The Council may create subcommittees or hire independent contractors to carry out Council responsibilities.

Section 7. Section 215.475, F.S., is amended to provide approval of the Investment Policy Statement by the Investment Advisory Council.

Section 8. Section 215.4754, F.S., is created to provide ethics requirements related to specific individual economic benefits that may accrue to investment advisors, managers, or members of the Investment Advisory Council.

Section 9. Section 215.4755, F.S., requires investment advisers or managers who contract with the state to develop and abide by a written code of ethics. These private advisers/managers have discretion to develop their own code but it must include criteria such as:

- Officers and employees shall refrain from personal business activity that could conflict with the proper execution and management of the investment program and could impair their ability to make impartial decisions.
- Officers and employees shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the board.

All investment decisions made on behalf of the trust fund and the board must be made “in the best interest” of the trust fund and the board. The private entities must confirm that they have appropriate safeguards in place to avoid influences that would result in adverse investment decisions. Each year these investment advisers and managers must certify in writing that they are complying with these ethics requirements. These investment advisers or managers must disclose any conflict of interest, and, at the request of the board, any nonconfidential, nonproprietary information or pecuniary interests the investment adviser or manager has with any party to a transaction with the board.

Section 10. Section 215.52, F.S., is amended to expand the authority of the board to develop policies, restrictions, and guidelines to implement provisions such as compliance, ethics, training, auditing, service providers, vendors, and third parties with whom it does business.

Section 11. The bill takes effect July 1, 2010.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

⁸ Note that this provision codifies an Attorney General Opinion that held that members of the Council were government employees for the purposes of sovereign immunity. Fla. Att’y Gen. Op. 02-26 (March 27, 2002).

B. Public Records/Open Meetings Issues:

Chapter 20, F.S., provides standard nomenclature on the classification of state governmental organizations. A committee is an entity created with a specific mission for a period not to exceed three years. This bill expands that nomenclature to confer upon an “audit committee” a continuing existence. While this may just be a misplacement of terms, the functions of the committee imply regular responsibilities and meetings at which its business is formalized. The context may imply that these must be *noticed* meetings under ch. 286, F.S., as the audit committee is a subordinate unit of the SBA with a specific set of statutory responsibilities. Meeting records will be in the public domain unless otherwise exempted under ch. 119, F.S., or other relevant law.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

The CS anticipates an increase in contracting between the SBA and private auditors and investors. These private contractors would benefit financially from their contracts with the state.

C. Government Sector Impact:

The CS increases the responsibilities and powers of the SBA and the Investment Advisory Council. Implementing these responsibilities, including any rulemaking done pursuant to these provisions, will cost money. Creating the audit committee with the prescribed expertise will cost money. The SBA estimates that the additional expenses will be under \$100,000 annually. Contracting with private auditors and investors will cost money. However, private assistance managing government funds was determined to be one of the “best practices” for public finance as determined by the 2009 Governance Research Project and may help the state see a larger return on its investments.

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.)

CS by Community Affairs on March 23, 2010:

The CS provides that the SBA will hold quarterly meetings and receive reports. The CS creates the Agency for Professional Fund Management and provides for the makeup of the agency.

CS by Governmental Oversight and Accountability on March 10, 2010:

The Committee Substitute expands the criteria upon which the board may adopt a rule, or issue a contract, for the disclosure of impermissible conflicts by outside financial advisers and consultants. The change was adopted to insulate the board from a challenge to the sufficiency of a subsequent policy change that itself was an exercise of non-rule policy, prohibited under the Administrative Procedures Act, ch. 120, F.S. The SBA is part of the Executive Branch of state government and all of the authority for its financial portfolio management is statutorily derived.

- B. **Amendments:**

None.