

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 Committee on Appropriations

BILL: CS/SB 110

INTRODUCER: Governmental Oversight and Accountability Committee and Senator Hooper

SUBJECT: State Board of Administration

DATE: April 12, 2023 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Harmsen</u>	<u>McVaney</u>	<u>GO</u>	<u>Fav/CS</u>
2.	<u>Shettle</u>	<u>Sadberry</u>	<u>AP</u>	<u>Pre-meeting</u>

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 110 makes several changes to the investing capabilities and other responsibilities of the State Board of Administration (SBA), relating to the administration of the Investment Plan. Specifically, the proposed committee substitute:

- Allows the SBA to hold its real estate investments in subsidiaries, and allows them to be grouped into a real estate financing pool, through which it may generate additional income;
- Raises the cap on alternative investments from 20 to 30 percent;
- Amends the due diligence information required to be given to the Investment Advisory Council in advance of investment in vehicles that are not explicitly approved by statute;
- Clarifies that the SBA cannot pay benefits to a member of the Investment Plan who has been charged with, or convicted of, specific offenses that evince a breach of the public trust;
- Permits a waiver of the requirement that a member of the FRS who wishes to designate a non-spouse as his or her beneficiary receive an acknowledgement of that designation from the spouse; and
- Updates terminology.

The bill is not expected to impact state or local government revenues or expenditures.

The bill takes effect upon becoming law.

II. Present Situation:

State Board of Administration Investing Duties

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

The SBA has responsibility for investing the assets of the Florida Retirement System (FRS) Pension Plan and administering the FRS Investment Plan,¹ which combined represent approximately \$195 billion, or approximately 84 percent, of the \$232.5 billion in assets managed by the SBA, as of November 30, 2022. The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees may choose in lieu of the Pension Plan. The SBA also manages over 25 other investment portfolios, with combined assets of \$37 billion, including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, the Florida Prepaid College Plan, and various debt-service accounts for state bond issues.²

The SBA follows fiduciary standards of care, subject to certain statutory restrictions and limitations when investing its assets.³ Pursuant to s. 215.444, F.S., a nine-member Investment Advisory Council provides recommendations on investment policy, strategy, and procedures. The SBA's authority to invest the funds, including 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 any fund may be invested in each investment type.⁴

As part of its best interests, maximization, and diversification actions, the SBA invests in multiple asset classes: global equities, fixed income, real estate, strategic investments, and private equity. Relevant to this legislation, s. 215.47(15), F.S., limits the SBA's authority to invest funds in alternative investments at not more than 20 percent of any fund. "Alternative investment" means an investment 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 The use of

¹ Section 120.4501(8), F.S. *See also*, R. 19-13.001, F.A.C.

² State Board of Administration, *Annual Investment Report: July 1, 2021 – June 30, 2022*, p. 2, available at <https://www.sbafla.com/fsb/Portals/FSB/Content/Performance/Annual/2021-2022-AIR.pdf?ver=2022-12-20-133041-763> (last visited Mar. 6, 2023).

³ Sections 215.44, 215.471, 215.472, 215.4725, and 215.273, F.S.

⁴ Section 215.47, F.S., sets some key guidelines such as:

- No more than 80 percent of assets may be invested in domestic common stocks.
- No more than 75 percent of assets may be invested in internally managed common stocks.
- No more than 3 percent of equity assets may 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 may be invested in the equity securities of any one corporation.
- No more than 80 percent of assets may be placed in corporate fixed income securities.
- No more than 25 percent of assets may 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 25 percent of assets may be invested in foreign corporate or commercial securities or obligations.

⁵ Section 215.4401(3)(a), F.S.

alternative investments vehicles was first authorized in 1996 at a maximum of 5 percent of a fund.⁶ In 2007, the use was expanded to include a broader spectrum of alternative investments, including private equity funds, venture funds, hedge funds, and distress funds.⁷ In 2008, this maximum threshold was increased to 10 percent.⁸ In 2012, the threshold was again increased to 20 percent.⁹

The table below shows key valuation and asset allocation data relating to the investments of the FRS pension plan assets. Over the three year period, the amount invested in the alternative investments (Strategic Investments and Private Equity) grew from 15.9 percent of the assets of the FRS to 21.4 percent of the assets, narrowing the capacity available under the 20 percent maximum threshold.

Asset Class	Dollar Volume (\$ billions) 6/30/2019 ¹⁰	Percentage of Fund 6/30/2019	Dollar Volume (\$ billions) 6/30/2022 ¹¹	Percentage of Fund 6/30/2022	Percentage Point Change in Assets Held by Fund
Global Equities	\$89.473	54.85%	\$87.054	48.40%	(6.45)
Fixed Income	\$30.715	18.83%	\$31.832	17.70%	(1.13)
Real Estate	\$15.266	9.36%	\$20.324	11.30%	1.94
Strategic Investments	\$14.029	8.60%	\$20.110	11.18%	2.58
Private Equity	\$11.902	7.30%	\$18.380	10.22%	2.92
Cash	\$1.747	1.07%	\$2.254	1.25%	(0.82)
Total	\$163.135	100%	\$179.855	100%	

The Private Equity asset class is generally described as illiquid with investment obligations contracted over at least a ten-year horizon. The Strategic Investments are typically quasi-liquid or illiquid with investment obligations contracted within a ten-year period. If the alternative investments pool volume begins to meet or exceed the statutory threshold, the SBA, in balancing its fiduciary duty against the statutory limitations, will be required to forego new investments in the assets class rather than divest in current active investments. Divesting in alternative investment vehicles to stay within the statutory threshold would require the SBA to sell assets prematurely, which may not be in the best interests of the fund.

FRS Investment Plan Investment Funds

While the SBA manages the funds that constitute the Pension Plan, they do not manage investments for the Investment Plan. The Investment Plan offers a diversified mix of primary investment funds in which the member can choose to invest his or her funds. These investment

⁶ Chapter 199-177, L.O.F., authorized the SBA to invest up to 5 percent of a fund in private equity through participation in limited partnerships and limited liability companies.

⁷ Chapter 2007-98, L.O.F.

⁸ Chapter 2008-31, L.O.F., increased the threshold to 10 percent and expanded this limitation to authorize SBA to invest in securities or investments that are not publicly traded and are not otherwise authorized in s. 214.47, F.S.

⁹ Chapter 2012-112, L.O.F.

¹⁰ State Board of Administration, *Annual Investment Report—Fiscal Year July 1, 2018 – June 30, 2019*, p. 16, available at https://www.sbafla.com/fsb/Portals/FSB/Content/Performance/Annual/2018_2019_AIR.pdf?ver=2020-02-20-125811-027 (last visited Mar. 6, 2023).

¹¹ State Board of Administration, *Annual Investment Report—July 1, 2021 – June 30, 2022*, available at <https://www.sbafla.com/fsb/Portals/FSB/Content/Performance/Annual/2021-2022-AIR.pdf?ver=2022-12-20-133041-763> (last visited Mar. 6, 2023).

funds are managed by private providers (such as Fidelity, Prudential, Stephens, T Rowe Price, and others) and have associated annual fees, as well as retirement objectives.¹²

Forfeiture of Retirement Benefits

Article II, s. 8 of the Florida Constitution provides that “[a]ny public officer or employee who is convicted of a felony involving a breach of public trust shall be subject to forfeiture of rights and privileges under a public retirement system or pension plan in such manner as may be provided by law.”

Section 112.3173 provides for the forfeiture of all rights and benefits under any public retirement system (both the Pension Plan and Investment Plan) by a public officer or employee who is convicted before his or her retirement of the following specified offenses:

- Embezzlement of public funds;
- Theft from his or her employer;
- Bribery in connection with his or her public employment;
- Any crime relating to bribery or misuse of a public office, under ch. 838, F.S.;
- Any impeachable offense;
- Any felony committed with intent to defraud the public or the employing agency, and through the commission of which, the member used or attempted to use his or her position’s power, rights, privileges, or duties to profit, gain, or realize an advantage; and
- Felony-level lewd or lascivious acts against a victim younger than 16, or felony sexual battery against a victim younger than 18, committed by using the member’s powers, rights, privileges, or duties of the member’s public position.

Additionally, s. 121.091(5)(f)-(h), F.S., provides for the member’s forfeitures of benefits (other than the member’s accumulated contributions). Section 121.091(5)(i), F.S., prohibits the Division of Retirement from distributing benefits should a member be found to have committed one of the crimes specified in s. 112.3173. The Division of Retirement distributes pension plan benefits, and the SBA distributes investment plan benefits.

III. Effect of Proposed Changes:

Section 1 amends s. 121.091(5)(i), F.S., to clarify that the SBA cannot pay retirement benefits to any member who has been convicted of a lewd and lascivious offense against a victim under the age of 16 (as defined in s. 800.04, F.S.), or sexual battery against a victim younger than 18 (as defined in ch. 794, F.S.), through the member’s use or attempted use of the power, rights, privileges, duties, or position of the member’s public office or employment. The bill makes a conforming change to s. 121.091(5)(k), F.S., to prohibit the SBA from paying retirement benefits during the pendency of such charges against the member. Current law prohibits only the Division of Retirement from paying member benefits based on those specified crimes.

Section 2 amends s. 121.4501(8), F.S., to allow the SBA to develop, create, and offer investment products in the investment plan as an alternative to those products offered by private provider.

¹² Florida Retirement System, *Investment Plan—Investment Fund Summary, January 2023*, p. 5, available at https://www.myfrs.com/pdf/forms/invest_fund_summary.pdf (last visited Mar. 6, 2023).

Section 2 amends s. 121.4501(20), F.S., to allow the SBA to waive the requirement that a member's spouse acknowledge the member's choice of a beneficiary other than the spouse. This waiver would apply when (1) the married member designates someone other than his or her spouse, (2) the spouse either cannot be located, or fails to affirmatively acknowledge the designation, and (3) the member then submits an affidavit that explains the circumstances and requests waiver of the spousal acknowledgement by the state board.

A waiver is not required in the case of designation of non-spouse contingent beneficiaries.

Section 2 also amends s. 215.47(6), F.S., to reduce the specific information the SBA must give to its Investment Advisory Council in advance on an investment that is not specifically authorized by ss. 215.44-215.53, F.S., and instead allows for a "detailed analysis of the investment" for any such proposed investment activity. This aligns with the resolution adopted that directs the SBA to invest based on pecuniary factors.¹³

Lastly, section 2 amends s. 215.47(15), F.S., to increase the amount of funds that the SBA may invest in alternative investments to 30 percent of total fund assets from 20 percent of total fund assets.

Section 3 amends s. 215.47(2), F.S., to allow the SBA to create subsidiary limited liability entities or joint ventures, otherwise known as a real estate financing pool. These subsidiary interests will be empowered to hold the SBA's investment mortgages and related instruments that are secured by real property, and instruments that contain provisions for equity or income participation or with provisions for convertibility to equity ownership, and interests in real property related collective investment funds.

The SBA is currently permitted to invest in these real estate vehicles, but states that the placement of the funds into subsidiaries would limit its liability exposure from these investments.

Current law allows the SBA to include costs for acquisition and operation of real property assets as part of its overall investment costs. The bill creates an additional method for the SBA to fund its real property subsidiaries' administrative operations by allowing both the SBA and those subsidiaries to issue securities and borrow money through loans or other financial obligations, including bonds, equity securities, and other security instruments. These instruments could be unsecured or secured by investments in real property or related cash flows, and guaranteed by the related fund or financial covenants.

The bill also makes conforming changes to terminology throughout to accommodate the SBA's creation of subsidiaries.

¹³ SBA, *A Resolution Directing an Update to the Investment Policy Statement and Proxy Voting Policies for the Florida Retirement System Defined Benefit Pension Plan, and Directing the Organization and Execution of an Internal Review* (Aug. 23, 2022), available at <https://www.flgov.com/wp-content/uploads/2022/08/ESG-Resolution-Final.pdf> (last visited Mar. 6, 2023).

Miscellaneous

The bill updates terms throughout, for example, substituting “entity” for “corporation” and “securities”¹⁴ for “stock” in order to reflect current industry terminology.

Sections 4, 5 and 6 respectively, reenact ss. 112.661, 420.503, and 1002.36, F.S., to incorporate the expansion of expressly authorized investments in s. 215.47, F.S., to apply to local retirement systems or plans, the Florida Housing Finance Corporation, and the Board of Trustees of the Florida School for the Deaf and the Blind.

Section 7 provides that the bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Not applicable. The mandate restrictions do not apply because the bill does not require counties and municipalities to spend funds, reduce counties’ or municipalities’ ability to raise revenue, or reduce the percentage of state tax shared with counties and municipalities.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

None identified.

¹⁴ A “security” is any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any interest or instrument commonly known as a ‘security’, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe or purchase, any of the foregoing. 115 U.S.C. §77b. Securities are generally governed by the Securities and Exchange Commission.

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

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

The SBA's foray into real estate financing pool investments may help to create an infusion of additional money into the overall funds managed by the SBA, including those which support the Pension Plan. This diversification may therefore ensure longer-term financial stability of the Pension Plan.

The SBA states that the increase in alternative investments cap would allow for more investment flexibility, and permit the funds to take advantage of the currently strong private equity market. Additionally, the SBA states that it will be required to forego new investments in alternative investments, as their investments currently meet the cap.¹⁵

Similarly, the SBA states that the ability to manage its real estate holdings as a real estate financing pool (owned through subsidiaries) would allow for greater flexibility and lower management costs.¹⁶

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 121.091, 121.4501, and 215.47.

This bill reenacts the following sections of the Florida Statutes: 112.661(5)(a), 420.503(3)(a), and 1002.36(4)(e).

¹⁵ SBA, *Senate Bill 110 Agency Analysis*, p. 3 (Mar. 3, 2023)(on file with the Senate Committee on Governmental Oversight and Accountability).

¹⁶ *Id.* at p. 2.

IX. Additional Information:

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

CS by Governmental Oversight and Accountability on March 7, 2023:

The CS makes the following changes:

- Clarifies that the SBA cannot pay benefits to a member of the Investment Plan who has been charged with, or convicted of, specific offenses that evince a breach of the public trust;
- Adds procedures to waive the requirement that a member of the FRS who wishes to designate a non-spouse as his or her beneficiary receive an acknowledgement of that designation from the spouse;
- Removes language that would direct the SBA to invest based on pecuniary factors only; and
- Removes approval to use subsidiary entities that hold alternative investments to issue securities and borrow money.

- B. **Amendments:**

None.