

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1307

State Financial Matters

SPONSOR(S): Schenck

TIED BILLS:

IDEN./SIM. BILLS: CS/SB 1078

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1)	Governmental Affairs Policy Committee		Haug	Williamson
2)	Government Operations Appropriations Committee			
3)	Economic Development & Community Affairs Policy Council			
4)				
5)				

SUMMARY ANALYSIS

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 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).

This bill includes changes to the FRS Investment Plan that codify practices and policies being used in administration of the plan since its inception. The bill:

- 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.
- 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.
- 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.
- Provides FRS Investment Plan administrative rate reductions.
- Provides additional time for FRS employers to pay invoices for member losses.
- Authorizes the SBA to secure trademarks, copyrights, and patents on behalf of the FRS or any other fund under its jurisdiction.

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.

The bill is expected to generate recurring revenues of \$9.45 million in fiscal years 2010-11, 2011-12, and 2012-13. It is expected to create recurring expenditures to the PEORP Trust Fund of \$12.7 million in fiscal years 2010-11, 2011-12, and 2012-13. In addition, it is expected to create recurring expenditures to the Forfeiture Trust Fund of \$9 million to \$10 million in the same fiscal years. The expenditures can be attributed to a decrease in employer contribution rates.

The bill has an effective date of July 1, 2010.

## 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 1999, the FRS has been partitioned into two separate benefits types:

- A defined benefit, or percent of final pay ("Pension") plan with a guaranteed annuitized benefit at retirement and an equity, 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 be violative of 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 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.

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.

### 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.

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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).

**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 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:

Recurring	<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u> <sup>13</sup>
	\$9,450,000	\$9,450,000	\$9,450,000
Non-Recurring	Unknown	Unknown	Unknown

#### 2. Expenditures:

Recurring	<u>FY 2010-11</u>	<u>FY 2011-12</u>	<u>FY 2012-13</u> <sup>14</sup>
DC Trust Fund	\$12,700,000	\$12,700,000	\$12,700,000
Forfeiture	\$9-10 million	\$9-10 million	\$9-10 million
Non-Recurring	Unknown	Unknown	Unknown

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

It is expected that local governments will experience a slight saving due to the reduction of the DC administrative contribution from 0.05 percent to 0.03 percent over the next four years.

<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).

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

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

There should be little impact on the private sector. Some money managers may receive some additional assets to invest.

D. FISCAL COMMENTS:

The SBA reviews each invoice as it is submitted to determine if some or all of it can be paid using monies from the Forfeiture Account. This review and use of the account has allowed the SBA to hold down payments from the PEORP Administrative Trust Fund which, in turn, has allowed the Trust Fund to grow to approximately \$34 million as of July 1, 2009. The 2009-2010 fiscal year PEORP budget allocates expenditures of \$9 million to \$10 million from the Forfeiture Account. The beginning balance for the Forfeiture Account for the fiscal year is approximately \$4.9 million, with expected inflows during the year of approximately \$8.5 million. The Forfeiture Account is generated through FRS Investment Plan participants terminating employment prior to vesting and not returning within the five year suspense window or by participants that commit a forfeitable offense.<sup>15</sup>

Revenues for the FRS Investment Plan are generated through a 0.05 percent retirement contribution on the gross salaries of all FRS members. The contributions are paid by all FRS employers on behalf of their FRS-covered employees. The current fiscal year revenues are projected at \$15.9 million, however, this could prove to be slightly high since new hires across the FRS have dropped considerably and salary increases are not as great or widespread as historically seen. Above revenue projections are based on a total payroll of \$31.8 billion for the FRS.<sup>16</sup>

The reduction from 0.05 percent to 0.03 percent will result in projected revenues of approximately \$9,450,000, a reduction of \$6,360,000 annually. The savings would be passed on to FRS employers.<sup>17</sup>

Expenditures for the FRS Investment Plan and MyFRS Financial Guidance Program are paid through two sources; the Investment Plan Administrative Trust Fund generated by the above revenues and the Investment Plan Forfeiture Account. The Forfeiture Account can only be used for two purposes, payment of FRS Investment Plan expenses and the reduction of future employer contributions to the plan. Current year administrative budget is \$12.7 million and it is expected that \$9 million to \$10 million will be used from the Forfeiture Account for a total of approximately \$21 million to \$22 million. Expenditures are expected to hold steady unless a major project or unanticipated vendor change is under taken.<sup>18</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.

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<sup>15</sup> State Board of Administration HB 1307 (2010) Substantive Bill Analysis (March 17, 2010) at 3 (on file with the Governmental Affairs Policy Committee).

<sup>16</sup> *Id.* at 5

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

2. Other:

None.

**B. RULE-MAKING AUTHORITY:**

The bill expands rule making authority regarding administration of the FRS Investment Plan beyond the current limiting language of “establishing the role and responsibilities of affected state, local government, and education-related employers, the state board, the department, and third-party contractors” by preceding that language with the phrase “including, but not limited to.”<sup>19</sup> As such, this appears to be an overly broad grant of rule making authority.

The bill also requires the SBA to develop procedures to receive and resolve participant complaints against the program, the third-party administrator, or any program vendor or provider. This appears to be a process that should be created through the rule making process.<sup>20</sup>

Finally, the bill requires the SBA to implement any policies, restrictions, or guidelines necessary in order to ensure full transparency and accountability in fulfillment of its fiduciary duties. This appears to be another grant of rule making authority and, as such, should be made more explicit.<sup>21</sup>

**C. DRAFTING ISSUES OR OTHER COMMENTS:**

Drafting Issues

Amendments are needed to limit the scope of rule making authority. At line 294 the words “but not limited to” are an unnecessary expansion of rule making authority. Also, at line 302 the words “develop procedures to” implies rule making authority and is redundant of the authority provided in Section 121.4501(8), F.S. Additionally, the words “or appropriate” needs to be removed from line 647 and language needs to be added to line 648 to clarify that the Board’s authority is included in current rulemaking authority.

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

Not applicable.

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<sup>19</sup> Lines 294-297 of the bill

<sup>20</sup> Line 302 of the bill

<sup>21</sup> Lines 647-655 of the bill