

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 Governmental Oversight and Accountability Committee

BILL: CS/SB 2186

INTRODUCER: Governmental Oversight and Accountability Committee

SUBJECT: State Board of Administration

DATE: March 10, 2010 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	Fav/CS
2.			GA	
3.			WPSC	
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 bill revises the operating practices of the Board of Administration to provide enhanced 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 bill substantially amends ss. 215.44, 215.441, 215.442, 215.444, 215.47, 215.475, and 121.153, of the Florida Statutes.

The bill also creates ss. 215.476 and 215.477, F.S.

II. Present Situation:

The Board of Administration (SBA), comprised of the Governor, Chief Financial Officer and Attorney General, is an off-budget state agency created by s. 16, art. IX, *Constitution of 1885*, and continued by s. 9, art. IX, *State Constitution*, as revised in 1968 and subsequently amended. The SBA manages thirty-six separate statutory investment portfolios, the largest one of which is the multi-employer Florida Retirement System, the Nation's fourth largest public pension plan.

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 State of Florida's SBA is considered a leader among the some ninety state pension plans in terms of organizational integrity and investment discipline. It 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 provide 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 SBA is directed 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.

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 and 5. Sections 215.442 and 215.444, F.S., are amended to include the Investment Advisory Council as a recipient of quarterly reports on downgraded securities and to affirm its role as a resources to the plan trustees. Members of the Council must themselves have relevant experience in institutional fund management. Council members are covered by sovereign immunity protection and are required to undergo fiduciary training. 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 and compensation studies.

Section 6. Section 215.475, F.S., is amended to provide approval of the Investment Policy Statement by the Investment Advisory Council.

Section 7. Section 215.4754, F.S., is created to provide disclosure requirements for investment advisers and managers.

Section 8. Section 215.4755, F.S., is created to authorize the SBA to include in its contractual documents provisions that require investment managers and advisers to make certain disclosures on personal business activity or pecuniary interests that could impair the independence of judgment required for the proper discharge of fiduciary duty.

Section 9. Section 215.52, F.S., is amended to expand the authority of the board to compel ethical compliance on the part of all parties with whom it does business.

Section 10. The bill takes effect July 1, 2010.

Other Potential Implications:

Later sections of this analysis discuss structural, and open meetings considerations on the statutory context of the audit committee, and the assignment of fiduciary duties to a non-fiduciary entity.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

None.

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:

Revised disclosure requirements will be made of the new members of the Investment Advisory Council and investment managers and advisers will have to file periodic reports on any conflicting relationships. There will be time associated with the completion of these tasks but its value cannot be monetized at this point.

C. Government Sector Impact:

There will be costs associated with the promulgation and adoption of rules as there is a discrete line charge for their publication in the Florida Administrative Code.

VI. Technical Deficiencies:

None.

VII. Related Issues:

An electronic communication from the fiduciary counsel of the SBA indicated there was a possibility that the Investment Advisory Council may now become a fiduciary. While not named as such, a party can accede to this role if the sum total of the constructive duties leads to this

result. To avoid a situation in which the Council may confront, rather than complement and advise the plan trustees, corrective language would be required to specifically disclaim this entity from a fiduciary role.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

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.