

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1013 State Board of Administration

SPONSOR(S): Stevenson

TIED BILLS: **IDEN./SIM. BILLS:** SB 1028

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Constitutional Rights, Rule of Law & Government Operations Subcommittee	10 Y, 0 N	Villa	Miller
2) Appropriations Committee	26 Y, 0 N	Willson	Pridgeon
3) State Affairs Committee			

SUMMARY ANALYSIS

The State Board of Administration (SBA) is responsible for investing the assets of the Florida Retirement System (FRS) Pension Plan and administering the FRS Investment Plan, which combined represent approximately \$190.8 billion, or 84.4 percent, of the \$225.4 billion in assets managed by the SBA. The SBA also manages over 25 other investment portfolios, with combined assets of approximately \$34.6 billion, including the Florida Hurricane Catastrophe Fund, the Florida Lottery Fund, and the Florida Prepaid College Plan.

The SBA's authority to invest the funds, including FRS assets, is governed by an authorized list of investments established in law, known as the "legal list." The legal list specifies the permitted types of investments as well as the total percentage that may be invested in each type. Currently, the SBA may invest 30 percent of any fund in alternative investments. Alternative investments are investments in a private equity fund, venture fund, hedge fund, or distress fund, or a direct investment in a portfolio company through an investment manager.

Alternative investments are generally illiquid and involve obligations contracted over multiple year periods. In response to this, the SBA employs a strategy of selling its interests on the secondary market to generate liquidity and rebalance its alternative investment portfolio. However, this approach represents a complete exit from the SBA's position.

Over the past several years, other financial instruments have gained prominence in the institutional investment landscape that allow fund managers to realize liquidity without necessitating the sale of portfolio assets. These tools include net asset value-based (NAV) facilities and collateralized fund obligations (CFOs). NAV facilities allow fund managers to borrow against committed capital, offering short-term access to cash without having to sell illiquid portfolio assets. CFOs involve issuing different tranches of debt securities, each with distinct risk and return profiles, with the cash flows from the underlying portfolio allocated to repay those tranches.

Unsecured debt instruments are not secured by any specific collateral and generally have higher associated interest rates.

The bill authorizes the SBA, or an affiliated limited liability entity, to issue securities and borrow money through loans or other financial obligations, including bonds, equity securities, and other security instruments, any of which may be unsecured, secured by alternative investments or related cash flows, guaranteed by the related fund, or governed by financial covenants. The bill caps such authorization at no more than 5 percent of any fund.

The bill does not appear to have a fiscal impact on the state or local governments.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Present Situation

State Board of Administration

The State Board of Administration (SBA) is established by Art. IV, s. 4(e) of the Florida Constitution, and is composed of the Governor as Chair, the Chief Financial Officer, and the Attorney General, commonly referred to as the “Board of Trustees.”¹ The SBA has responsibility for investing the assets of the Florida Retirement System (FRS) Pension Plan² and administering the FRS Investment Plan,³ which combined represent approximately \$190.8 billion, or approximately 84.4 percent, of the \$225.4 billion in assets managed by the SBA, as of October 31, 2023.⁴ The SBA also manages over 25 other investment portfolios, with combined assets of approximately \$34.6 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.⁵

Investment decisions for the pension plan are made by fiduciaries hired by the state. Under Florida law, an SBA fiduciary charged with an investment decision must act as a prudent expert would under similar circumstances, considering all relevant substantive factors. A nine-member Investment Advisory Council (IAC) provides recommendations to the SBA on investment policy, strategy, and procedures and serves as a resource to the Board of Trustees.⁶

The SBA’s authority to invest the funds, including FRS assets, is governed by an authorized list of investments established in law, known as the “legal list.”⁷ The legal list specifies the permitted types of investments as well as the total percentage that may be invested in each type of investment and provides that:

- No more than 80 percent of any fund may be invested in domestic equity securities;
- No more than 75 percent of any fund may be invested in internally managed equity securities;
- No more than 3 percent of equity assets may be invested in the equity securities of any one issuing entity, except to the extent a higher percentage of the same issue is included in a nationally recognized market index, based on market values, or except upon a specific finding by the SBA that such higher percentage is in the best interest of the fund;
- No more than 25 percent of any fund may be invested in specific instruments, such as certain bonds or other obligations of other states or of municipalities or other political subdivisions, notes secured by first mortgages insured or guaranteed by the Federal Housing Administration or the United States Department of Veterans Affairs, investment-grade group annuity contracts of the pension investment type, certain interests in real property, certain bonds or instruments issued by the government of Israel, foreign government general obligations, or other asset-backed securities;
- No more than 50 percent of any fund may be invested in foreign corporate or commercial securities or obligations; and
- No more than 30 percent of any fund may be invested in alternative investments.^{8,9}

¹ See also Art. XII, s. 9, FLA. CONST.

² S. 121.151, F.S.

³ S. 121.4501(8), F.S. See also, R. 19-13.001, F.A.C.

⁴ State Board of Administration, *Performance Report Month Ending: October 31, 2023*,

<https://www.sbafla.com/fsb/Portals/FSB/Content/Performance/Trustees/2023/October%202023%20Monthly%20Trustee%20Report.pdf?ver=2023-12-22-140235-787> (last visited January 10, 2024), herein “State Board of Administration 2023 Report.”

⁵ *Id.*

⁶ S. 215.444(1), F.S.

⁷ S. 215.47, F.S.

⁸ “Alternative investment” means an investment by the SBA in a private equity fund, venture fund, hedge fund, or distress fund or a direct investment in a portfolio company through an investment manager. S. 215.4401(3)(a), F.S.

⁹ S. 215.47, F.S.

In addition, the SBA may invest up to 5 percent of any fund as it deems appropriate. However, before making such investment, the SBA must present a proposed plan for such investment to the IAC. The proposed plan must include a detailed analysis of the investment, the expected benefits and potential risks, and methods for monitoring and measuring performance.¹⁰

In 2023, the Legislature authorized the SBA to hold certain interests in real property and related personal property through limited liability entities or joint ventures. The SBA and its affiliated limited liability entities and joint ventures may issue securities and borrow money through loans or other financial obligations, including bonds, equity securities, and other security instruments, any of which may be unsecured, or secured by investments in real property or related cash flows, guaranteed by the related fund, or governed by financial covenants.¹¹

Alternative Investments

To diversify its investments, the SBA invests in multiple asset classes: global equities, fixed income, real estate, cash equivalents, strategic investments, and private equity.¹² The table below shows the asset allocation and valuation data for FRS Pension Plan assets over the past two years.¹³

Asset Class	Dollar Value (billions) 10/31/22	Percentage of Fund 10/31/22	Dollar value (billions) 10/31/23	Percentage of Fund 10/31/23	Total Percent Change from 2022-2023
Global Equities	\$84,976	48.6%	\$84,791	48.1%	(0.5)
Fixed Income	\$28,675	16.4%	\$29,263	16.6%	0.2
Real Estate	\$21,506	12.3%	\$20,977	11.9%	(0.4)
Cash Equivalents	\$2,098	1.2%	\$2,292	1.3%	0.1
Strategic Investments	\$20,282	11.6%	\$21,330	12.1%	0.5
Private Equity	\$17,310	9.9%	\$17,628	10.0%	0.1
Total	\$174,847	100%	\$176,281	100%	0.82

As noted above, the SBA may not invest more than 30 percent of any fund in alternative investments through participation in alternative investment vehicles¹⁴ or in securities or investments that are not publicly traded and not otherwise authorized by the legal list. The use of alternative investment vehicles was first authorized in 1996 at a maximum of 5 percent of a fund.¹⁵ 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.¹⁶ In 2008, the maximum threshold was increased to 10 percent of a

¹⁰ S. 215.47(6), F.S.

¹¹ Ch. 2023-111, Laws of Fla., codified in part in s. 215.47(2)(e), F.S. The proceeds of such loans or financing obligations may be loaned to or otherwise used as a source of funding for affiliated limited liability entities or joint ventures.

¹² The SBA categorizes their investments in the asset classes in the following manner:

- Global equity: primarily consists of equities in companies located in the United States and abroad.
- Fixed income: primarily consists of investment grade bonds.
- Real estate: primarily consists of directly owned real properties, real estate-based joint ventures, open-end and closed-end funds, and publicly traded real estate securities.
- Cash equivalents: primarily consists of short-term securities that have a high credit quality and liquidity.
- Strategic investments: contains investments not suitable for inclusion in the other asset classes, such as hedge funds, private debt, infrastructure, and timberland.
- Private equity: primarily consists of equity investments in non-publicly traded entities through limited partnerships.

State Board of Administration, *Summary Overview of the State Board of Administration of Florida*, https://www.sbafla.com/fsb/Portals/FSB/Content/Topics/SBAOverview_20211025.pdf?ver=2021-10-28-120954-217 (last visited January 10, 2024).

¹³ See State Board of Administration, *Performance Report Month Ending: October 31, 2022*, <https://www.sbafla.com/fsb/Portals/FSB/Content/Trustees/2022/October%202022%20Monthly%20Trustee%20Report.pdf?ver=2023-01-03-095602-000> (last visited January 10, 2024); see also State Board of Administration *2023 Report*, *supra* note 4.

¹⁴ "Alternative Investment Vehicle" means the limited partnership, limited liability company, or similar legal structure or investment manager through which the State Board of Administration invests in a portfolio company. S. 215.4401(3)(a)2., F.S.

¹⁵ Ch. 96-177, s. 5, Laws of Fla., authorized the SBA to invest up to 5 percent of a fund in private equity through participation in limited partnerships and limited liability companies.

¹⁶ Ch. 2007-98, s. 1, Laws of Fla.

fund.¹⁷ In 2012, the threshold was increased to 20 percent.¹⁸ In 2023, the threshold was increased to the present limit of 30 percent.¹⁹

Alternative investments are generally illiquid and involve obligations contracted over multiple year periods. In response to this, the SBA employs a strategy of selling its interests on the secondary market to generate liquidity and rebalance its alternative investment portfolio. However, this approach represents a complete exit from the SBA's position.²⁰

Over the past several years, additional financial instruments have gained prominence in the institutional investment landscape that allow fund managers to realize liquidity without necessitating the sale of portfolio assets. These tools include net asset value-based (NAV) facilities and collateralized fund obligations (CFOs). NAV facilities allow fund managers to borrow against committed capital, offering short-term access to cash without having to sell illiquid portfolio assets.²¹ CFOs represent a structured finance approach that securitizes future cash flows. CFOs involve issuing different tranches of debt securities, each with distinct risk and return profiles, with the cash flows from the underlying portfolio allocated to repay those tranches.²²

Unsecured debt instruments are not secured by any specific asset and instead typically rely on the borrower's creditworthiness. Interest rates on unsecured debt instruments are generally higher due to the inherent associated risk.²³

Effect of the Bill

The bill authorizes the SBA, or an affiliated limited liability entity, to issue securities and borrow money through loans or other financial obligations, including bonds, equity securities, and other security instruments, any of which may be unsecured; secured by alternative investments or related cash flows; guaranteed by the related fund; or governed by financial covenants. The bill caps such authorization at no more than 5 percent of any fund.

B. SECTION DIRECTORY:

Section 1 amends s. 215.47, F.S., relating to Investments; authorized securities; loan of securities.

Section 2 provides an effective date of upon becoming law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

¹⁷ Ch. 2008-31, s. 3, Laws of Fla., 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. 215.47, F.S.

¹⁸ Ch. 2012-112, s. 1, Laws of Fla.

¹⁹ Ch. 2023-111, s. 3, Laws of Fla.

²⁰ See State Board of Administration, Agency Analysis of 2023 HB 1139 (dated March 18, 2023), on file with the Constitutional Rights, Rule of Law & Government Operations Subcommittee.

²¹ See Mayer Brown, *The Advantages of Net Asset Value Credit Facilities*, <https://www.mayerbrown.com/en/perspectives-events/publications/2023/03/the-advantages-of-net-asset-value-credit-facilities> (last visited January 10, 2024).

²² See Mayer Brown, *Collateralized Fund Obligations: A Growing CDO/CLO and Fund Finance Liquidity Solution*, <https://www.mayerbrown.com/en/perspectives-events/publications/2023/08/collateralized-fund-obligations-a-growing-cdo-clo-and-fund-finance-liquidity-solution#:~:text=A%20close%20sibling%20of%20collateralized,and%20equity%2C%20and%20other%20similar> (last visited January 10, 2024).

²³ Mark Henricks and Mitch Strohm, *Unsecured vs. Secured Debts: What's the Difference*, Forbes Advisor (dated August 12, 2021), <https://www.forbes.com/advisor/debt-relief/unsecured-vs-secured-debts/> (last visited January 10, 2024).

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

The SBA indicates the bill will have a positive fiscal impact on the funds under its management. The SBA emphasizes that the capacity to generate liquidity and strategically rebalance or reposition alternative investment portfolios is integral to the effectiveness of a well-managed and high-performing alternative investment program. The SBA asserts that it currently faces a disadvantage by not having all options available to generate liquidity or adjust its alternative investment portfolio as necessary, should market conditions warrant.²⁴

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. The bill does not appear to affect county or municipal governments.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill neither authorizes nor requires additional executive branch rulemaking.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

²⁴ See State Board of Administration, Agency Analysis of 2023 HB 1139 (dated March 18, 2023), on file with the Constitutional Rights, Rule of Law & Government Operations Subcommittee.