



February 2013

Report No. 13-05

FRS Pension Plan Investment Returns Are Similar to Those of Other States; SBA Is Increasing Alternative Investments

at a glance

The State Board of Administration (SBA) has generally met market-based investment benchmarks for its largest funds, including the Florida Retirement System Pension Plan. In addition, the Pension Plan's 10-year performance exceeded that of similarly sized funds in other states. However, recent market volatility has made it difficult for the board to meet its overall investment objective for the plan.

To help generate returns needed to achieve the Pension Plan's objectives, the SBA has increased the proportion of the plan's assets invested in alternative investments, such as private equity funds. Given the increased monitoring needed with such investments, the board has implemented additional oversight procedures.

Scope

Section 215.44(6), *Florida Statutes*, requires OPPAGA to perform a biennial evaluation of the State Board of Administration's (SBA) management of investments. This review examines the SBA's Fiscal Year 2010-11 and 2011-12 performance and answers two questions.

- In general, how well are the SBA's major mandate funds performing?
- How does the SBA plan to implement the legislatively authorized increase in alternative investments?

Background

The State Board of Administration is primarily an asset management organization charged by the Florida Constitution and state law with investing funds contributed on behalf of state agencies, school boards, educational institutions, and units of local government.¹ The board is composed of the Governor, Chief Financial Officer, and Attorney General, who serve as trustees to the funds under board management. The trustees appoint the SBA's executive director, who oversees the general management of investments.

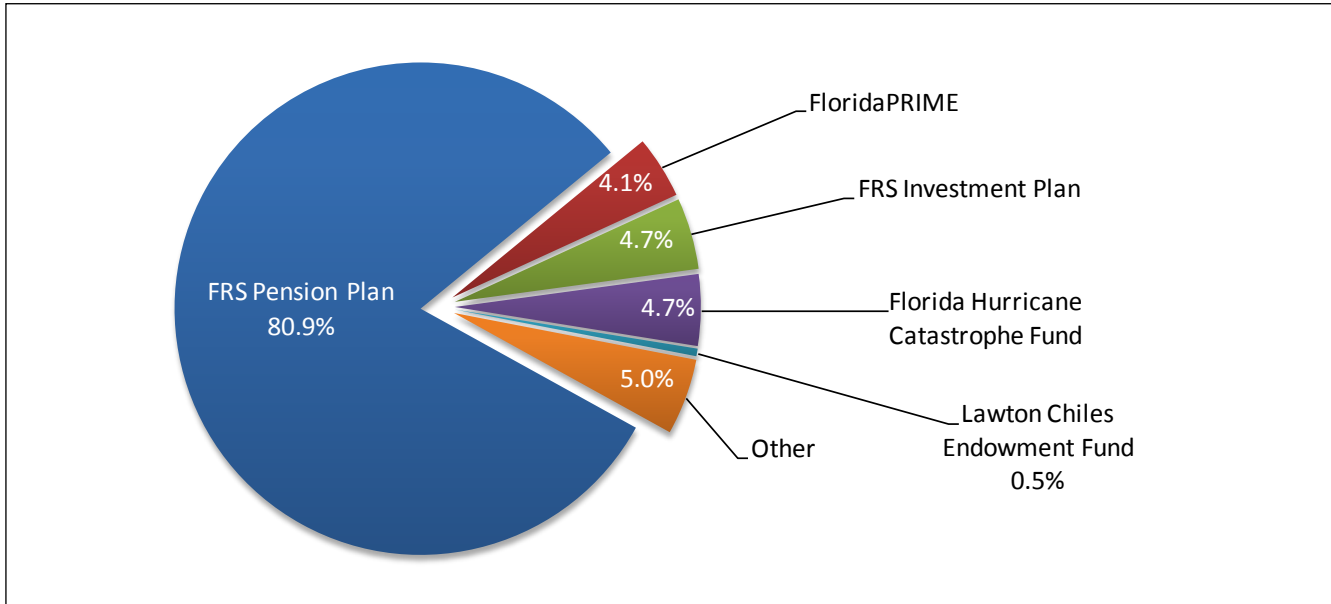
As of June 30, 2012, the board managed 36 funds with a total market value of over \$151 billion. The SBA's major mandate investment funds are the Florida Retirement System (FRS) Pension Plan, the FRS Investment Plan, the Florida Hurricane Catastrophe Fund, the Florida PRIME Fund, and the Lawton Chiles Endowment Fund.² As shown in Exhibit 1, the largest of these is the FRS Pension Plan, which had net assets of \$122.7 billion and comprised 81% of the total assets managed by the board. Appendix A includes more information on the board's major mandate funds.

¹ The SBA also invests funds on behalf of direct-support organizations of the state and political subdivisions.

² SBA defines mandate investment funds as those for which board responsibilities are required by state law. SBA refers to the five largest of these as "major" mandates. Other SBA mandate funds include the Florida Lottery Fund and the Florida Prepaid College Plan Fund.

Exhibit 1

The Total Market Value of SBA Investments Was \$151.7 Billion as of June 30, 2012¹



¹ “Total market value” refers to the net value of the SBA’s assets as of June 30, 2012.

Source: OPPAGA analysis of State Board of Administration data.

The SBA does not receive legislative appropriations of general revenue or trust funds to support its activities. Instead, its operational and administrative expenses are funded through fees derived from its investment management services and contributions to the Florida Retirement System. In Fiscal Year 2011-12, the board had an operating budget of \$32,993,394 and 183.5 authorized positions.³

Questions and Answers

In general, how well are the SBA’s major mandate funds performing?

The State Board of Administration uses several methods to evaluate fund performance. These methods include examining investment returns relative to market-based benchmarks,

comparing the investment returns to those of other large investors, and comparing these returns to the board’s overall investment objective for each fund. Because benchmarks are calculated using varied approaches and for different purposes, the market-based benchmarks should not be compared to the overall investment objectives.

We reviewed the SBA’s performance in investing fund assets using these methods. In general, we found that

- the SBA’s major mandate funds have met their market-based benchmarks;
- FRS Pension Plan investment returns were generally higher than those of other states over a 10-year period but were lower in recent years; and
- FRS Pension Plan returns have not consistently met the SBA’s overall investment objective over the last 15 years.

³ Additionally, the SBA had 39 positions and budgeted \$26.5 million for the Florida Hurricane Catastrophe Fund, the Division of Bond Finance-Arbitrage Compliance, the Division of Bond Finance-Revenue Bond Fee, and the FRS Investment Plan/Office of Defined Contribution.

The SBA's major mandate funds have generally met market-based investment benchmarks. The State Board of Administration's investment returns are important because the earnings help fund a range of state and local government efforts, including pension benefits. Exhibit 2 shows historical annualized investment returns for each of the board's five major funds.

In general, the SBA investment returns for the five major mandate funds compare favorably to the funds' internal benchmarks over 1-, 3-, 5-, and 10-year periods.⁴ The SBA Board of Trustees sets these benchmarks using standard market indices.⁵

⁴ The Florida Hurricane Catastrophe Operating Fund did not meet a benchmark during this biennial, missing its 5-year benchmark of 1.26% by 0.12%. The FRS Investment Plan and the Lawton Chiles Endowment also missed their respective 1-year benchmarks by 0.1%. Return rates presented in Exhibit 2 may differ due to rounding.

⁵ A market index tracks and measures changes in the performance of a specific group of stocks, bonds, or other investments from a specific starting date. As an example, the performance of domestic equities within the Pension Plan fund is measured against the Russell 3000 Index, which is an index measuring the performance of approximately 3,000 of the largest companies in U.S. stock markets.

For example, the FRS Pension Plan had a 0.29% return for Fiscal Year 2011-12, which exceeded its 1-year benchmark by 0.78%.

The SBA's fund benchmarks vary widely based on the state's goals for the individual funds. For example, for a fund used for emergencies or short-term goals, like the Hurricane Catastrophe Fund, assets must be liquid so they can be distributed quickly in the event of a disaster. Generally, investments that can be easily converted into cash have lower returns and lower associated benchmarks. Conversely, the SBA's goal for investing FRS Pension Plan assets is to provide investment returns sufficient to ensure timely payment of promised benefits to current and future FRS Pension Plan participants. To obtain sufficient returns, FRS Pension Plan assets are primarily invested in longer-term investments that have increased risks but higher potential returns. As such, these investments generally have higher benchmarks.

Exhibit 2

As of June 30, 2012, Most SBA Fund Returns Exceeded Market-Based Investment Benchmarks for Periods up to 10 Years

	1-Year Trailing Return ¹	3-Year Trailing Return	5-Year Trailing Return	10-Year Trailing Return
Florida Retirement System				
<i>FRS Pension Plan</i>	0.3%	11.8%	1.6%	6.4%
Performance Benchmark	-0.5%	10.5%	1.2%	6.1%
<i>FRS Investment Plan</i>	1.1%	9.9%	1.4%	N/A
Performance Benchmark	1.2%	9.4%	0.8%	N/A
Hurricane Catastrophe Fund				
<i>CAT Operating Fund</i>	0.4%	0.8%	1.1%	2.1%
Performance Benchmark	0.1%	0.1%	1.3%	1.9%
<i>CAT 2007A Fund</i>	0.3%	0.5%	N/A	N/A
Performance Benchmark	0.1%	0.1%	N/A	N/A
Lawton Chiles Endowment				
	2.9%	13.6%	1.4%	6.3%
Performance Benchmark	3.0%	13.2%	1.1%	6.0%
Florida PRIME Fund				
	0.3%	0.3%	1.3%	2.1%
Performance Benchmark	0.1%	0.2%	1.2%	1.9%

¹ A trailing return shows how a fund has performed over the period shown. For example, a 1-year trailing return as of June 30, 2012, would show a fund's performance from July 1, 2011, to June 30, 2012. A 10-year trailing return as of June 30, 2012, would show a fund's performance from July 1, 2001, to June 30, 2012.

Source: State Board of Administration.

FRS Pension Plan 10-year performance is higher than that of most other large public pension funds, but recent returns are lower. Compared to other large state pension funds, the SBA’s investment performance for investing FRS Pension Plan assets is average or higher for the 10-year term.^{6,7} (See Exhibit 3.) Specifically, despite the economic downturn and lower recent returns, in Fiscal Year 2011-12 the FRS Pension Plan’s 10-year return (6.4%) was equal to or higher than that of 8 of 10 large public pension funds we reviewed.

In addition, FRS Pension Plan Fund returns exceed those of several other large state pension funds for a 3-year period. However, FRS Pension Plan Fund returns were lower than the returns for most of the comparison funds over the last year.

According to SBA officials, the FRS Pension Plan’s returns in recent years were below those of other states primarily because of low returns on global equity investments. The SBA reports that the FRS Pension Plan’s global equity investments returned -5.11% in Fiscal Year 2011-12.⁸ Because global equities account for nearly 60% of the pension plan’s assets, there is a strong tie between global equity performance and FRS Pension Plan performance.

⁶ Because the FRS Pension Plan Fund is the largest fund the SBA administers, we chose to focus on its performance in more detail.

⁷ We compared FRS Pension Plan Fund returns to the returns of 10 large public pension funds: the California Public Employees’ Retirement System, the California State Teachers’ Retirement System, the Employees’ Retirement System of Texas, the New Jersey Public Employees’ Retirement System, the New York Employees Retirement System, the North Carolina Teachers and State Employees Retirement System, the Ohio Public Employee Retirement System, the Pennsylvania State Employees’ Retirement System, the Teacher Retirement System of Texas, and the Wisconsin Retirement System.

⁸ Returns presented are absolute (i.e., stand-alone) and as such, do not measure the relative contribution of the global equity decline to a decline in the returns for the FRS Pension Plan.

Exhibit 3

Ten-Year Returns for the FRS Pension Plan Favorably Compare to Those of Other Large Public Retirement Plans, but the Fund’s Short Terms Returns Are Relatively Low¹

Fund	Overall Rate of Return				Market Value of Pension Assets (in Billions)
	10-Year	5-Year	3-Year	1-Year	
FRS Pension Plan	6.4%	1.6%	11.8%	0.3%	\$122.7
California Public Employees’ Retirement System	5.7%	1.2%	13.5%	1.9%	\$237.6
California State Teachers’ Retirement System	6.5%	0.3%	12.0%	1.8%	\$151.3
Employees’ Retirement System of Texas	5.3%	3.9%	Unknown	12.4%	\$22.1
New Jersey Public Employees’ Retirement System	5.2%	5.2%	4.2%	18.0%	\$73.7
New York Employees Retirement System	6.4%	2.9%	15.2%	6.0%	\$153.4
North Carolina Teachers and State Employees Retirement System	5.7%	5.1%	4.4%	18.5%	\$74.9
Ohio Public Employees Retirement System	5.5%	1.7%	11.1%	0.2%	\$74.0
Pennsylvania State Employees’ Retirement System	6.0%	1.0%	7.8%	2.7%	\$24.4
Teacher Retirement System of Texas	5.8%	4.0%	3.6%	15.5%	\$107.4
Wisconsin Retirement System (Core Fund)	7.1%	2.1%	Unknown	1.3%	\$74.9

¹ Information on the FRS Pension Plan is as of June 30, 2012. Reporting dates from other states ranged from June 30, 2011, to June 30, 2012. Some data from New Jersey excludes police and firefighter programs.

Source: State Board of Administration data and OPPAGA review of comprehensive annual financial reports from other states’ pension funds.

The SBA has not consistently met its overall investment objective for the FRS Pension Plan Fund over the short term. Although the SBA's investments have generally exceeded market-based benchmarks and have done relatively well compared to other states' pension funds, the SBA has not consistently met its overall investment objective for the FRS Pension Plan. This objective is an absolute rate of return, or the gain or loss in the fund as a percentage of investment. The objective measures how the fund is performing over multiple market cycles (e.g., over 15 years). The SBA's overall investment objective is for the FRS Pension Plan to achieve investment earnings of 5% over the annual rate of inflation.⁹ As such, the

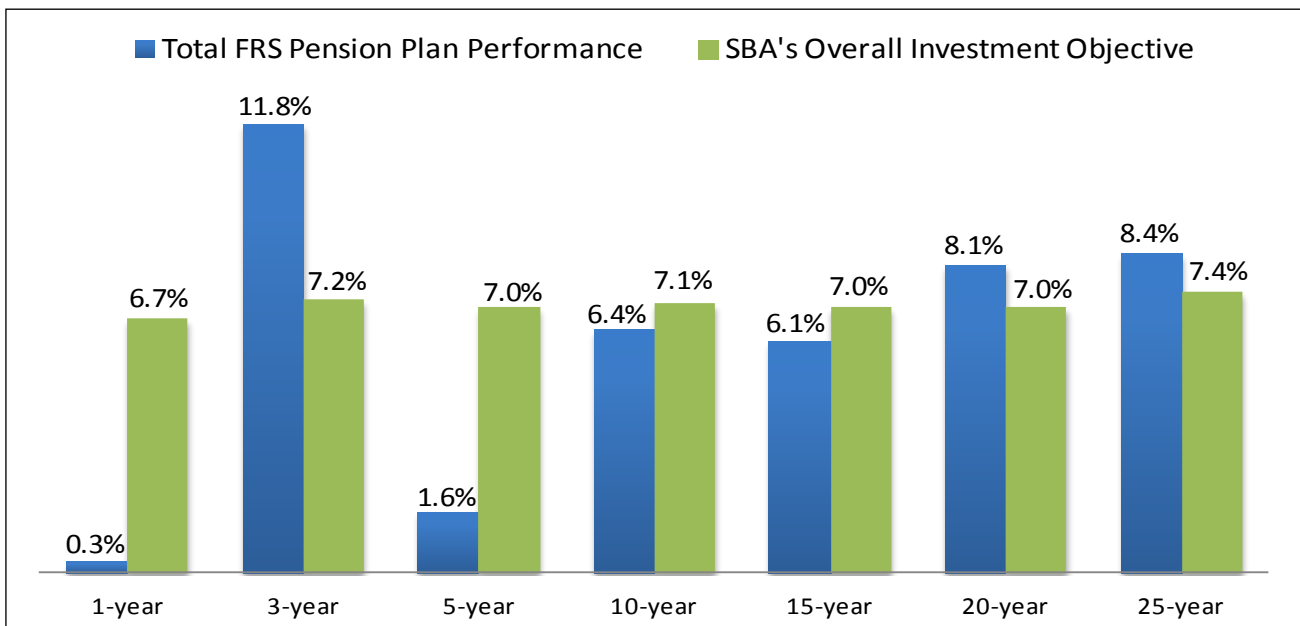
objective will vary slightly every year. (See Exhibit 4.)

For Fiscal Year 2011-12, the SBA's calculations resulted in an overall investment earnings objective of 6.74%. This is similar to the investment earnings objectives of other large public plans. For example, the Wisconsin Retirement System seeks to achieve a real rate of return over the growth in member wages. In the latest reporting year (2012), this system's investment objective was 7.2%, with a real rate of return of 4% over an estimated 3.2% growth in wages.

As shown in Exhibit 4, the SBA has consistently met its overall investment earnings objective for the FRS Pension Plan Fund for the long-term (e.g., 20 years and greater), although returns did not consistently meet this objective for shorter terms (e.g., 5, 10 and 15 years). The SBA reported that returns likely reflect the impact of the "technology bubble" bursting early in the last decade and the more recent mortgage crisis and global recession and related decline in the market value of traditional equity investments.

⁹ The SBA Board of Trustees sets the overall investment objective. The SBA reports that this objective is designed to closely track the investment return assumed by the Florida Retirement System actuary. It is based on an analysis of expected benefit growth, contribution levels, market performance, and risk tolerance for the fund. The SBA uses the compounded U.S. Department of Labor Consumer Price Index to represent the inflation rate.

Exhibit 4
The SBA's Pension Plan Investment Returns Did Not Consistently Meet the Board's Overall Investment Objective for the Period Ending June 30, 2012



¹ The relatively high 3-year return is related to an unusually large 22% return on FRS Pension Plan assets in Fiscal Year 2010-11, reflecting a broad recovery in the markets.

Source: OPPAGA analysis of State Board of Administration data.

Achieving a desired overall rate of return in the current market has been difficult for many other state pension plans, primarily due to ongoing market turmoil abroad. Like Florida, state pension plans in California, New York, Ohio, and Pennsylvania recently reported difficulties in achieving their pension funds' investment return objectives, particularly in the short- to middle-term. For example, the Ohio Public Employees Retirement System's 5- and 10-year returns for 2011 (1.7% and 5.5%, respectively) were below the 8% investment return rate assumed by the system's actuary. Similarly, as of June 30 2012, California reported that its California State Teachers' Retirement System had 5- and 10-year returns of 0.3% and 6.5% respectively, below the system's 7.5% investment return assumption.

How does the SBA plan to implement the legislatively authorized increase in alternative investments?

Historically, alternative investments have represented a relatively small proportion of SBA assets and have achieved mixed returns. Florida law defines an alternative investment as an investment by the State Board of Administration in a private equity fund, venture fund, hedge fund, or distress fund, or a direct investment in a portfolio company through an investment manager.¹⁰

The SBA separates these alternative investments into two asset classes: private equity investments and strategic investments. Private equity investments are made via limited partnerships, including venture capital, business expansion, or business acquisitions. Strategic investments include some kinds of stocks, participatory notes, and other interests, such as hedge funds, timber funds, and debt oriented investment vehicles. Both private equity and strategic investments are generally conducted outside the public securities markets.

The FRS Pension Plan is the SBA's only major mandate fund that includes alternative investments. For the quarter ending June 30, 2012,

the board's alternative investments had a market value of \$11.8 billion, which at that time was an estimated 9.6% of total FRS Pension Plan assets. Compared to the FRS Pension Plan's holdings in global equities (56.5%) and fixed income investments (25.5%), these investments constituted a relatively small proportion of overall plan assets. Appendix B describes several of the SBA's FRS Pension Plan alternative investments during this period.

In addition, the SBA's Fiscal Year 2011-12 allocation to alternative investments in the FRS Pension Plan was relatively low compared to national averages. A 2012 survey of institutional investors, including public pension plans, estimated that the allocation to alternatives in these plans ranged from 15% to 22%.¹¹ The SBA's allocation was also smaller than the allocations of some other large public pension funds we reviewed. Among our comparison state pension plans, 4 of the 10 invested 14% or more of their pension assets in alternative investments during the period from June 30, 2011, through June 30, 2012. Of these funds, the Pennsylvania State Employees' Retirement System had the highest allocation of plan assets to alternative investments, with 35%. States reported that they pursued increased allocations in alternative investments in order to meet their assumed rates of return in a variable financial market.

Similar to other states, SBA officials report that the goals for alternative investments include achieving potentially better risk diversification and investment returns than those found in traditional markets, thereby improving the plan's ability to pay benefit obligations, and providing a hedge against inflation. Specifically, the board's long-term goal for the strategic investments asset class is a 5% annualized real rate of return, which is higher than the unadjusted target return for the FRS Pension Plan as a whole.

The SBA's Board of Trustees sets a unique industry-accepted benchmark for each alternative investment. Like other Pension

¹⁰ Section 215.4401(3)(a), *F.S.*

¹¹ Wilshire Trust Universe Comparison Service, August 2012, and 2012 *Global Survey on Alternative Investing*, Russell Investments, June 2012.

Plan asset classes, these are market-based benchmarks.¹² The board adjusts and monitors these benchmarks on a monthly basis, and its summaries of alternative investment performance suggest that, in general, these assets are achieving or exceeding their targets. (See Exhibit 5.)

**Exhibit 5
Alternative Investments Met Most of the SBA’s
Earnings Benchmarks as of June 30, 2012¹**

Period	Managed Return	Benchmark Return ²	Value-Added
1-Year	6.51%	5.68%	0.84%
3-Year	17.97%	15.73%	2.23%
5-Year	4.99%	3.69%	1.30%
10-Year	6.77%	9.70%	-2.93%
15-Year	8.25%	7.24%	1.01%
20-Year	8.57%	7.96%	0.61%
Since Inception (January 1989)	9.22%	9.84%	-0.63%

¹ Data represents real returns for the quarter ending June 30, 2012, and excludes public market investments.

² The benchmarks and returns are aggregated across all of the SBA’s alternative investment asset classes.

Source: State Board of Administration.

The SBA has increased the proportion of the FRS pension funds invested in alternative investments. SBA officials report that because of its historically low allocation to alternative investments, Florida may have lost potential earnings when global markets declined. To address this concern, the SBA’s Board of Trustees gave the executive director authority to seek legislative expansion of the state’s investment in alternative investment vehicles. Through Ch. 2012-112, *Laws of Florida*, the 2012 Legislature authorized the SBA to increase its allocation to alternative investments from 10% to 20%.

Since the 2012 law’s passage, the SBA has begun to increase its allocation to alternative investments to counter market risk and to increase income. Under the expanded

authority, the board plans to increase the asset allocation for these investments from just under 10% to 16%. The SBA plans to increase the allocation of private equity from 4% to 5% and to increase the strategic investment allocation from just over 4% to 11%. Over the next two years, the SBA plans to invest in several sub-asset classes, such as buyouts, hedge funds, timberland, and distressed debt. (See Appendix B for definitions of these investments.) According to board officials, actual patterns of new investment will be determined by the opportunities available in the market.

The SBA will provide higher levels of oversight for alternative investments. Because of the relatively higher risk associated with alternative investments, the SBA plans to provide a higher level of oversight for these investments. The board recently generated new oversight mechanisms in response to a review by an outside consultant.¹³ In particular, the consultant recommended that the board formalize an external compliance program for private equity and strategic investments. In response, the SBA has implemented a range of tools for external manager oversight, including

- developing oversight procedures, certifications, questionnaires, and scorecards;
- creating a risk-based system for conducting planned on-site evaluations and scheduled evaluations for the upcoming year;
- establishing procedures for compliance testing of private equity and strategic investment managers/funds and quarterly contractual compliance checks on a sample of managed accounts and funds; and
- instituting quarterly investment oversight meetings.

In addition to addressing their consultant’s recommendations, the SBA is implementing several industry best practices for managing

¹² For example, the earnings targets for many of the SBA’s alternative investments in Fiscal Year 2011-12 were the returns for the Russell 3000 Index plus 300 basis points or the Consumer Price Index plus 500 basis points.

¹³ *State Board of Administration: Evaluations and Recommendations Related to the Compliance Program*, Crowe Horwath, October 21, 2011.

alternative investments. For example, the board plans to send staff to attend operational due diligence training (e.g., assessing fund documentation, contractual arrangements, valuation methodology, and identification of other non-investment related risks). Moreover, the SBA plans to systematically examine the strategic investment portfolio's risk exposures and is evaluating a range of software packages that would assist in this effort.

Finally, SBA officials report that the board is strategically seeking optimal management fee terms for alternative investments. Because these investments are actively managed, they generated a disproportionate share of the external manager

fees associated with the FRS Pension Plan investments. During Fiscal Year 2011-12, the SBA's total external manager fees were \$345.3 million, with 45% (\$154.5 million) devoted to managing alternative investments. Returns on investing fund assets generally cover these external manager costs. However, the SBA has been able to negotiate lower alternative investment management fees when dealing with smaller investment funds and those parts of the market in which the board has more market power, including specific hedge funds.

Agency Response ---

In accordance with the provisions of s. 11.51(2), *Florida Statutes*, a draft of our report was submitted to the State Board of Administration for review and response. The written response has been reproduced in Appendix C.

OPPAGA supports the Florida Legislature by providing data, evaluative research, and objective analyses that assist legislative budget and policy deliberations. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021), by FAX (850/487-9213), in person, or by mail (OPPAGA Report Production, Claude Pepper Building, Room 312, 111 W. Madison St., Tallahassee, FL 32399-1475). Cover photo by Mark Foley.

OPPAGA website: www.oppaga.state.fl.us

Project conducted by Emily Leventhal, Rich Woerner, and Rose Cook
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Appendix A

Description of SBA Major Mandate Investment Funds

Five funds comprised approximately 95% of all State Board of Administration investments as of June 30, 2012—the Florida Retirement System’s (FRS) Pension Plan, the FRS Investment Plan, the Florida Hurricane Catastrophe Fund, the Florida PRIME Fund, and the Lawton Chiles Endowment Fund.

Florida Retirement System Funds. The Florida Retirement System-related funds are the largest funds managed by the SBA. The FRS is the retirement plan for employees of state and county government agencies, district school boards, community colleges, and state universities, and serves as the retirement plan for 185 municipalities and 243 independent special districts. The SBA is responsible for investing and administering the two FRS-related funds: the FRS Pension Plan and the FRS Investment Plan.

FRS Pension Plan. The Legislature established the defined benefit FRS Pension Plan in 1970 and it is currently the nation’s fourth largest pension system.¹⁴ The FRS Pension Plan comprises 80.9% of the funds managed by the board and had a net asset value of \$122.7 billion as of June 30, 2012. The SBA is responsible for investing FRS Pension Plan assets to help ensure that investment returns are sufficient to fund current and future pensioners.

FRS Investment Plan. The 2000 Legislature established the defined contribution FRS Investment Plan, which is similar to private sector 401(k) plans that allow employees to choose and manage their own investments.^{15, 16} The FRS Investment Plan had a net asset value of \$7.1 billion as of June 30, 2012, 4.7% of the SBA’s managed assets.

Florida Hurricane Catastrophe Fund. The Florida Hurricane Catastrophe Fund is a tax-exempt trust fund created by the 1993 Legislature. The fund’s purpose is to provide a stable and ongoing source of reimbursement to insurers for a portion of their catastrophic hurricane losses in order to provide additional insurance capacity for the state. The fund had net asset values of \$7.2 billion as of June 30, 2012, 4.7% of the SBA’s managed assets.

Florida PRIME Fund. The Local Government Surplus Funds Trust Fund (now known as the Florida PRIME Fund) was created in 1977 to help local units of government earn interest on pooled surplus funds. The fund had net asset values of \$6.2 billion as of June 30, 2012, 4.1% of the SBA’s managed assets.

Lawton Chiles Endowment Fund. The Legislature created the Lawton Chiles Endowment Fund in 1999. The portfolio was funded with \$1.7 billion of Florida’s tobacco litigation settlement proceeds. The endowment fund’s purpose is to invest a portion of the settlement monies to provide a perpetual source of enhanced funding for health maintenance and research programs related to tobacco use. The fund had net asset values of \$776 million as of June 30, 2012, 0.5% of the SBA’s managed assets.

¹⁴ Under a defined benefit retirement plan, benefits are based on a formula that takes into account an employee’s years of service, salary, age at retirement, and membership class.

¹⁵ Under a defined contribution plan, employees receive an amount at retirement that has accrued from investments. The amount accrued is based on several factors, including how much employers and employees contribute, the types of investments selected by employees, and how well these investments perform over the employees’ careers.

¹⁶ The FRS Investment Plan was first offered to employees in Fiscal Year 2002-03.

Appendix B

Description of SBA Investment Strategies and Selected Alternative Investments

The State Board of Administration invests in a wide range of alternative investment vehicles each year. These are both short- and long-term investments that include a range of different funds and varied investment strategies. Exhibit B-1 describes some of the strategies that the SBA uses for alternative investments.

Exhibit B-1 SBA Alternative Investment Strategies

Strategy	Description
Buyout and Leveraged Buyout	Buyouts involve acquiring a publically traded company. Sometimes investors use debt, such as bank loans and bonds, in what is called a leveraged buyout. Because of the large amount of debt relative to equity in the new corporation, the bonds are rated below investment grade and categorized as high-yield or junk bonds. A leveraged buyout allows a company to be taken over with little capital, but it can be a high-risk endeavor.
Debt and Distressed Debt	Generally, a debt strategy will involve buying a company's bonds. Distressed debt involves purchasing debt in an unprofitable company that is likely to go bankrupt. This is considered a high-risk security with the potential for high return if the company can avoid bankruptcy or liquidation. This can include vehicles such as mezzanine funds, which are a hybrid of debt and equity financing, typically used to finance the expansion of existing companies.
Growth	Growth funds typically offer higher capital appreciation, often with above-average risk. Companies in a growth fund portfolio are in an expansion phase and are not expected to pay dividends. Investing in growth funds requires a tolerance for risk and a holding period with a horizon of 5 to 10 years.
Hedge	Investments in hedge funds involve an aggressively managed portfolio that makes extensive use of unconventional investment tools, such as derivatives, as well as long and short positions (i.e., predicting that the value of stocks or other financial instrument will go either up or down and investing accordingly).
Real Asset	Includes acquisition of physical or tangible assets that have value due to their substance and properties. Real assets include precious metals, commodities, real estate, agriculture, and oil.
Secondary	Private equities are investments going directly into private companies. The secondary market allows private equity investors to sell positions in private equity funds and liquidate equity stakes in private companies.
Venture Capital	This strategy involves private equity stakes in startup and small- and medium-sized enterprises with strong growth potential. These investments are generally characterized as high-risk/high-return opportunities.

Source: OPPAGA review of investment literature.

Exhibit B-2 describes several of the FRS Pension Plan's alternative investments during Fiscal Year 2011-12.

Exhibit B-2

Examples of SBA Alternative Investments in Fiscal Year 2011-12

	Strategy	Description ¹
Private Equity		
Chartwell Capital Investors	Growth	Seeks primarily non-technology investments in mid-to-late stage growth companies in the Southeast and Pacific Northwest
Carlyle Asia Growth Partners IV	Growth	Buyout transactions of expansion/growth capital companies (international)
Lexington Capital Partners VII, LP	Secondary	Targets interests in buyout, mezzanine (debt and equity financing), and venture capital partnerships (domestic and international)
Pantheon Venture Partners II, LP	Venture Capital	Investments in venture capital partnerships (domestic and international)
True Bridge/FLSBA Special Purpose	Venture Capital	Investments in venture capital opportunities
Berkshire Fund VII	Leveraged Buyout	Investments in mid-market companies in consumer and retail, services, industrials, transportation, and communication sectors
Riverside Europe Fund IV	Leveraged Buyout	Seeks to execute buyout investments at lower middle market companies (Europe)
Trident V	Leveraged Buyout	Seeks to make control-oriented investments in cash flow or service companies with proven business models and quality management teams (domestic and the Caribbean)
Warburg Pincus X	Leveraged Buyout	Growth-oriented investments from venture capital transactions to later stage buyout transactions across a range of sectors (domestic and Asia)
Strategic Investments		
Carlyle Mezzanine Partners II	Debt Oriented	Executes mezzanine investments in middle market companies to finance the expansion of existing companies
Goldman Sachs Distressed Opportunities	Debt Oriented	Seeks direct and indirect investments in private and publicly issued debt securities and privately issued equity securities companies that are in financial or operational distress
Airline Credit Opportunities II	Other Opportunistic (Distressed Debt)	Invests in unleveraged acquisitions of aircraft and aircraft-related obligations
GI Partners III	Other Opportunistic (Corporate Finance/Buyout)	Seeks to complete middle market and large buyouts within a range of sectors (domestic and Western Europe)
Highline Capital Partners	Hedge	Invests in equities, both long and short, with low net exposure to the equity market
King Street Capital Fund	Hedge	Seeks investments in long and short credit and event-driven investments (international)
Jackson Timberland Opportunities	Real Asset	Timberland property management

¹ If not otherwise specified, the investment is North American.

Source: OPPAGA review of State Board of Administration information.

Appendix C



STATE BOARD OF ADMINISTRATION
OF FLORIDA

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February 19, 2013

Mr. R. Philip Twogood
Coordinator
Office of Program Policy Analysis & Government Accountability (OPPAGA)
Claude Pepper Building, Room 312
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Mr. Twogood:

We reviewed the preliminary and tentative OPPAGA's report titled: *FRS Pension Plan Investment Returns Are Similar to Those of Other States; SBA Is Increasing Alternative Investments*. We have no objection or questions regarding the information presented in the report.

We welcome OPPAGA's efforts and, as always, we appreciate your diligence and professionalism.

Sincerely,

A handwritten signature in blue ink that reads "Ashbel C. Williams".

Ashbel C. Williams
Executive Director & CIO