

Executive Director's Report

DEAR FRS MEMBER:

With a focus on global investing and strategies to reduce risk and enhance long-term growth, the State Board of Administration (SBA) is managing and investing assets on behalf of its largest client base, the 1.1 million members and beneficiaries of the Florida Retirement System (FRS), as well as for 34 other mandates and trusts. At the end of fiscal year 2007-08, the total net asset value of the 35 mandates and trusts under SBA management was \$154.7 billion.

FRS PENSION PLAN

The FRS Pension Plan – the fourth largest public pension plan in the nation – was fully funded for the 11th consecutive year, with an estimated \$8.7 billion surplus, a major achievement considering the fact that most state public pension funds in the United States are underfunded. In a year when domestic and foreign stock markets tumbled amid a severe economic downturn, the FRS Pension Plan's return outperformed broad market indexes, with a modest net loss of 4.4%. The FRS Pension Plan's long-term strength, consistency and growth have made it one of the best-performing public pension plans in the nation.

For the fiscal year ended June 30, 2008, the net asset value of the FRS Pension Plan was \$126.9 billion, compared with \$136.3 billion a year earlier. The FRS Pension Plan accounted for 82% of total assets under the SBA's management. Reflecting a very difficult equity and bond market environment, the return of the FRS Pension Plan portfolio for the year was a loss of 4.4%. During this time, the U.S. stock market was down 12.7% and foreign stocks fell 7.5%. These declines reflected investor concerns about the slowdown in the U.S. economy, sharply higher oil and commodity prices, inflationary pressures, lower corporate earnings, the credit crisis caused by plunging home prices, a weaker dollar and other factors. Fiscal year 2007-08 was the first in eight years that the FRS Pension Plan return was not positive.

Though uncomfortable, market cycles are a fact of life for investors. To put this year's performance in perspective, the FRS Pension Plan investment results followed an unusually strong return of 18.1% in fiscal year 2006-07. Over the five years ending June 30, 2008, the annualized return of the Pension Plan portfolio was 9.91%; over the past 15 years, it was 8.99%. The SBA is focused on generating healthy long-term returns in the FRS Pension Plan, not aggressive short-term returns that bear excessive risk and volatility.

For the fiscal year, the FRS Pension Plan continued to rank in the top half of the best-performing pension plans over all reporting periods, as reported by Wilshire Trust Universe Comparison Service.

FRS INVESTMENT PLAN

During the fiscal year, eligible public sector employees in Florida continued to enroll in the FRS Investment Plan, a growing alternative to the FRS Pension Plan. Approximately 13% of all active FRS-covered members were enrolled in the FRS Investment Plan at fiscal year-end, up from 12% a year earlier. Modeled after private sector 401(k) plans, the FRS Investment Plan is a voluntary defined contribution plan that gives participants a choice of diversified investment options, control of their retirement plan assets and benefits they retain even if they leave the FRS.

In the fiscal year ended June 30, 2008, total assets in the FRS Investment Plan grew to \$4.37 billion from \$3.69 billion in the previous year, reflecting a 19% increase in enrollment. The composite total return for all FRS Investment Plan assets was a loss of 4.69%, net of investment management fees, but the Plan outperformed its benchmark.

2007-08 highlights.

largest mandate.

SBA managed the \$126.9 billion FRS Pension Plan, which remained fully funded for the 11th straight year.

assets under management.

SBA managed a total of 35 mandates and trusts with a combined net asset value of \$154.7 billion.

a portable retirement alternative.

Enrollment in the SBA-administered FRS Investment Plan rose 19%, total assets increased to \$4.37 billion.

moving forward.

SBA implemented important changes to stabilize and protect the Local Government Investment Pool and its liquidity.

reducing risk.

SBA adopted tougher risk management, compliance and oversight policies.

enhancing compliance.

SBA retained Deloitte & Touche to evaluate and enhance its compliance practices and policies.

managing risk.

SBA protected Florida's investments through focused corporate governance and investor activism.

a mandate beyond investment management.

SBA managed Florida Hurricane Catastrophe Fund assets to provide a vital safety net for residential property insurance.

executive transition.

Robert Milligan became Interim Executive Director and guided the SBA during a challenging transition year.

leadership for the future.

The SBA Trustees appointed Ashbel C. Williams, Jr., Executive Director & CIO, effective October 2008.

The SBA provides planning resources to all FRS members through our award-winning MyFRS Financial Guidance Program, which offers workshops, educational print materials and videos, free and confidential telephone access to financial planners from Ernst & Young and the Florida Division of Retirement, and access to online resources through MyFRS.com.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP)

Since the early 1980's, the SBA has managed the LGIP, an investment pool designed for local government surplus funds. LGIP experienced a liquidity crisis in the fall of 2007 when participants withdrew an unprecedented \$14 billion in funds from the Pool in a single month. The withdrawals were triggered by fears of exposure to so-called subprime commercial paper. Although the LGIP bought only first-tier investments (i.e., no subprime exposure), media reports fueled investor fears about the quality and security of the investments. The bottom line is that many participants lost confidence in the LGIP, leading to what can best be described as a classic "bank run" that drained the liquidity of the Pool.

Working at the direction of the SBA Trustees and the Florida Legislature, the SBA implemented a series of major changes that will enhance and strengthen the security and performance of the LGIP going forward. Also, we hired Federated Investors to manage the LGIP, and we restored the full liquidity of the LGIP in December 2008.

OTHER DEVELOPMENTS

The SBA put new investment, oversight, compliance, risk management and reporting policies in place following a series of independent audits and in accordance with new state laws to protect Florida's assets even further.

The SBA also approved a plan during the fiscal year to retain Deloitte & Touche in fiscal year 2008-09 to help us become even better in the area of risk management and compliance. Deloitte & Touche will review and assess our compliance, investment management and business processes, and make recommendations for ultimate implementation.

During the fiscal year, the SBA implemented the requirements of a new state law that prohibits Florida's public pension monies from being invested in non-U.S. companies that aid the governments of Sudan and Iran.

THANK YOU

I want to thank the SBA Trustees for their strong leadership and guidance and the Florida Legislature for their commitment to supporting initiatives that safeguard the state's assets and investments. I also want to acknowledge the service and contributions of Coleman Stipanovich, who resigned as Executive Director in December 2007. I would also like to express my gratitude to General Robert Milligan who guided the SBA as Interim Executive Director from December 2007 through October 2008. His strong leadership, guidance, and service to the people of Florida helped the SBA achieve its stated goals. As your new Executive Director, I am committed to achieving the SBA's mission of providing superior investment and trust services while adhering to the highest ethical, fiduciary, and professional standards.

For a full copy of the investment report, go to www.SBAFLA.com and click SBA 2007-2008 Investment Report on the home page.

Sincerely,

Ashbel C. Williams
Executive Director & CIO

by the numbers.

membership.

Pension Plan Working	590,194
Pension Plan Retired	274,708
Pension Plan Terminated Vested	85,267
Investment Plan Working	95,392
Investment Plan Terminated w/ Balance	<u>19,572</u>
GRAND TOTAL	1,105,970

Pension Plan funding.

Funded ratio *	107.1%
# Public Plans w/ Surplus (incl. Pension Plan)	9 (or only 7%)
Largest Public Retirement Plans Rank	6 th best funded
Pension Plan Surplus *	\$8.7 billion

* Preliminary 2008 actuarial valuation data.

FRS Pension Plan Investment Returns
Annualized Rates Ending June 30, 2008



FRS Investment Plan Net Asset Value
(in billions)

