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DATE: February 21, 2000

**HOUSE OF REPRESENTATIVES
AS FURTHER REVISED BY THE COMMITTEE ON
FINANCE & TAXATION
ANALYSIS**

BILL #: CS/HB 303 by the Committee on Finance & Taxation and Rep. Andrews

RELATING TO: Investment of Public Funds

SPONSOR(S): Representative Andrews

TIED BILL(S): None

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) GOVERNMENTAL OPERATIONS (PRC) YEAS 6 NAYS 0
 - (2) COMMUNITY AFFAIRS (PRC) YEAS 9 NAYS 0
 - (3) FINANCE & TAXATION (FRC) YEAS 14 NAYS 0
 - (4) GENERAL GOVERNMENT APPROPRIATIONS (FRC)
 - (5)
-

I. SUMMARY:

The bill provides uniform guidelines for the investment of public funds by school districts, counties, municipalities and special districts. The bill creates investment policy guidelines, limitations, and conditions for the investment of the assets of local retirement plans, and of other public funds available to units of local government. Also, the bill authorizes the Department of Revenue and the Department of Banking and Finance to withhold certain funds from local governments or school boards which fail to meet certain reporting requirements.

The bill appears to have no apparent fiscal impact on either state or local governments.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|------------------------------|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

The 1994, 1995, 1996, and 1997 Florida Division of Retirement (Division) Annual Reports noted several continuing concerns regarding the investment of public funds by school districts, special districts, and local governments. In these reports, the Division noted a lack of uniform standards regarding investments of pension program funds subject to Part VII of Chapter 112, Florida Statutes. The Division found plans with no stated standards applicable to investments, and other plans with standards which were disregarded, or were not uniformly and consistently applied. The Division has repeatedly made specific statutory recommendations related to some of the following ongoing issues of concern:

- The need for a uniform investment standard for local governmental pension plans similar to the requirements for the state retirement system found in section 215.47, Florida Statutes;
- The need for a pre-approved investment plan for each local government pension plan;
- Assets for which a fair market value is not provided;
- Undefined terms used in Part VII of Chapter 112, Florida Statutes;
- Violations of the qualification requirements provided in the Internal Revenue Code of the United States;
- Language in Chapters 175 and 185, Florida Statutes, which puts these chapters into conflict with the federal Age Discrimination in Employment Act;
- The need to establish audit policy that is applicable to all public pension plans;
- The need to establish funding policy for school boards early retirement programs, and;
- The need to modify the Division's oversight responsibilities pursuant to Part VII of Chapter 112, Florida Statutes.

This year the Division has expanded prior recommendations regarding audit policy, and has made recommendations regarding the Division's oversight responsibilities.

Numerous statutes, including, Chapters 28, 112, 125, 159, 166, 218, 219, 236 and 237, Florida Statutes, contain provisions related to the investment and reinvestment of public funds by counties, cities, special districts, county officers, and district school boards.

There is a lack of uniformity in these statutes providing limitations, conditions and procedures related to the investment of public funds.

The statutes relating to surplus funds allow local government entities to invest in the Local Government Surplus Funds Trust Fund administered by the State Board of Administration (SBA), or they may invest the funds themselves in certain federal obligations and in specified types of securities.

Under part IV of Chapter 218, Florida Statutes, the "Investment of Local Government Surplus Funds Act" (the Act), the Local Government Surplus Funds Trust Fund is created to serve as a repository for funds deposited by units of local government to be invested by the SBA in the same manner and subject to the same restrictions as apply to investment of moneys in the Florida Retirement System Trust Fund (section 215.47, Florida Statutes). The SBA is also authorized to provide technical assistance to local governments in the investment of surplus funds.

Section 218.415, Florida Statutes, requires local governmental entities that have custody of public funds, but choose not to deposit them in the Local Government Surplus Funds Trust Fund for investment by the SBA, to conduct other investment activity in accordance with a written investment plan, or alternatively, to invest in specified low-risk instruments. Units of local government without an investment plan are limited to investing in the following:

- The Local Government Surplus Funds Trust Fund, or any intergovernmental investment pool authorized pursuant to the Florida Interlocal Cooperation Act;
- Securities and Exchange Commission registered money market funds with the highest credit quality rating from a nationally recognized rating agency;
- Savings accounts in state-certified qualified public depositories;
- Certificates of deposit in state-certified qualified public depositories;
- Direct obligations of the U.S. Treasury; or
- Federal agencies and instrumentalities. ("Federal agencies and instrumentalities" investments include all securities issued by agencies of the federal government or corporations created by Congress, such as obligations of the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.)

Section 218.415, Florida Statutes, provides a blueprint for a written investment plan. It spells out required and recommended investment policies to be developed by units of local government. Such investment policies are to be applied to funds under the control of the local government which are in excess of those required to meet current expenses. The investment plan must contain certain elements which provide, for example:

- The investment objectives of the local government must include safety of capital, liquidity of funds, and investment income, in that order of priority;
- A list of authorized investments, including whether investments in derivative products are expressly authorized;

- A description of how the portfolio is structured to match liquidity to pay obligations with investment maturities;
- Arrangements for the holding of the assets of the local government;
- A system of internal controls; and
- Requirements for the chief financial officer to report to the governing body of the local government on the performance of the investment portfolio.

The Auditor General conducted a survey of the implementation of section 218.415, Florida Statutes, by local governments, which is described in Report No. 13283, issued on July 16, 1998. Based on the results of the survey, the report concludes that... “[m]any local governments have not fully complied with the requirements set forth in Section 218.415, Florida Statutes. With respect to local governments which limit their investment activities to those investment options listed in section 218. 415(15), Florida Statutes, the report finds that these local governments not only unnecessarily limit their investment options, but also do not benefit from the investment safeguards afforded by a written investment policy.”

In its review of local governments with an adopted investment policy, the results of the survey of local governments indicate that not all local governments follow their own investment policy. Specifically, the Auditor General’s report finds that the internal controls contemplated by section 218.415(13), Florida Statutes, “have not been effectively implemented to promote compliance with s. 218.415, Florida Statutes.” For example, the investment plans of 13 percent of the 95 local governments surveyed did not include a system of internal controls and operational procedures, and 41 percent of the plans did not require that the controls and procedures be reviewed by independent auditors as part of the local government’s financial audit.

The Division continues to find aggravated problems, such as improper distributions, which result from insufficient accountability of local investment activity.

Sections 125.31 and 219.075, Florida Statutes, (counties), section 166.261, Florida Statutes, (municipalities), section 218.345, Florida Statutes, (special districts), and section 236.24, Florida Statutes, (school boards), for example, impose requirements on investments by such local governmental units which are in some cases inconsistent with the requirements of section 218.415, Florida Statutes.

Section 112.61, Florida Statutes, in part, provides that “...except as herein provided, it is the intent of this act to prohibit the use of any procedure, methodology, or assumptions the affect of which is to transfer to future taxpayers any portion of the cost which may reasonably have been expected to be paid by the current taxpayers.”

Several annual reports provided examples of illiquid investments reported at book value which substantially exceeded the market value. The use of the overstated value results in higher funding requirements commencing at later dates (when such illiquid investments are sold, or the loss is finally recognized), contrary to the stated intent of section 112.61, Florida Statutes. It has been difficult to obtain fair market values when such values are not reported.

C. EFFECT OF PROPOSED CHANGES:

The bill provides uniform guidelines for the investment of public funds by school districts, counties, municipalities and special districts. The bill creates investment policy guidelines, limitations, and conditions for the investment of the assets of local retirement plans, including those subject to Chapter 112, Florida Statutes, and of other public funds available to units of local government.

The bill also provides uniform structure among plans, and encourages pension plan policy makers to maximize financial returns. Additionally, the bill requires and enables units of local government to more prudently manage plans.

The clerk of the circuit court is required to invest such funds pursuant to the provisions in section 218.415, Florida Statutes, replacing previous investment vehicles, and attendant procedures relating to those investments. The previous investment vehicles are interest-bearing or federal government obligations with historically low yields.

By providing for investments described in section 218.415, Florida Statutes, the universe of investments is increased. Also, such investments, with attendant procedures and limitations, conform with those of other units of local government.

By using the investments described in section 218.415, Florida Statutes, rather than the investments described in sections 28.33, 125.31, 166.261, 218.345, 219.075, 236.24, and Chapter 280, Florida Statutes, future pool financing investments (investment of bond proceeds and moneys held for debt service) pursuant to section 159.416, Florida Statutes, will now conform with those of other units of local government.

By using the investments described in section 218.415(16), Florida Statutes, rather than those formerly referred to, such (future) investments by school boards will now conform with those of units of local government *electing to adopt a written investment policy*.

Removing references to investments and reinvestments, and related procedures, results in the scope of section 236.24, Florida Statutes, being limited to the *sources* of funds available for district school funds; whereas section 236.24, Florida Statutes, currently provides for acceptable investments for surplus district school funds.

Several statutory provisions are repealed by the bill as the investment policy provisions of the bill supersede those statutory provisions.

Finally, the Department of Revenue and the Department of Banking and Finance are specifically authorized to withhold funds from local governments or school boards if certain required information is not provided.

D. SECTION-BY-SECTION ANALYSIS:

Section 1 -- Amends definitions, and adds a definition in section 112.625, Florida Statutes.

- Subsection (7) is amended to provide that the “statement value” of assets *excludes* from assets used in the determination of annual funding cost, assets for which a fair market value is not provided.
- Subsection (8) is amended to add the terms “board”, and “board of trustees” as designated person or persons, and providing definition to the terms.
- Subsection (9) adds a definition for the term “plan sponsor”.

Section 2 - Creates section 112.661, Florida Statutes.

- Provides that investments of assets of any local retirement system or plan must be consistent with a *written investment policy* adopted by the organization designated to make investment decisions;
- Provides that plans adopt written investment policies which must be structured to maximize the financial return to the retirement systems or plans, consistent with risks incumbent in each investment. Investment policies must also be structured to establish and maintain an appropriate diversification of the retirement systems’ or plans’ assets; and
- Provides that investment policies include: scope; investment objectives; performance measurements; investment and fiduciary standards; authorized investments; maturity and liquidity requirements; portfolio composition; risk and diversification; expected annual rate of return; third-party custodial agreements; a master purchase agreement; bid requirements; internal controls; continuing education; reporting; filing of investment policy; and the valuation of illiquid investments.

Section 3 - Amends section 218.415, Florida Statutes, relating to local government excess funds investment policies.

- Amends subsection (1) SCOPE, by requiring the applicability of the investment policy to trust funds by deleting the language providing that investment policy shall *not* apply to trust funds;
- Amends subsection (3) PERFORMANCE MEASUREMENT, by requiring the investment policy (rather than the *unit of local government*) to specify (rather than *develop*) performance measures appropriate for the nature and size of the funds within the custody of the unit of local government;
- Amends subsection (5) LISTING OF AUTHORIZED INVESTMENTS, by specifying that the investment policy list investments authorized *by the governing body of the unit of local government*, subject to subsection (16) [which is the complete list of investments authorized by statute when a unit of local government adopts a written investment policy related to the investment or reinvestment of surplus public funds]. Further, *investments not listed in the investment policy are prohibited*, and

if the investment policy authorizes derivatives investments, officials responsible for making investment decisions or the chief financial officer (rather than the *chief financial officer*, only), must have sufficient understanding and expertise relative to such investments;

- Amends subsection (11) MASTER REPURCHASE AGREEMENT, by providing that the *investment policy* (rather than the *unit of local government*), shall require compliance with the Master Repurchase Agreement;
- Amends subsection (12) BID REQUIREMENT, by providing that the *investment policy* require staff to analyze and select investments, and competitively bid selections. Also, except as otherwise required by law, the *bid deemed to best meet the investment objectives* must be selected;
- Amends subsection (13) INTERNAL CONTROLS, by providing that *officials responsible for making investment decisions or the chief financial officer* (rather than the *chief financial officers, only*), shall establish a system of internal controls;
- Renumbers subsection (14) to (15) REPORTING, and amends it, by providing that the government entity's *officials responsible for making investment decisions or the chief financial officer* (rather than the *chief financial officer, only*), prepare certain reports;
- Creates a new subsection (14) CONTINUING EDUCATION, which provides that the investment policy include relevant educational and training requirements;
- Creates subsection (16) AUTHORIZED INVESTMENTS; WRITTEN INVESTMENT POLICIES, which provides which investment and reinvestment vehicles are authorized for units of local government electing *to adopt* a written investment policy;
- Renumbers subsection (15) to (17) AUTHORIZED INVESTMENTS; NO WRITTEN INVESTMENT POLICY, and amends it, by providing which investment or reinvestment vehicles are authorized for surplus public funds for units of local government electing *not to adopt* a written investment policy [pursuant to subsections (1) - (15)];
- Creates subsection (18) SECURITIES; DISPOSITION, which provides for proper earmarking and handling of securities;
- Creates subsection (19) SALE OF SECURITIES, which provides conditions and method of selling securities, and handling of sale proceeds;
- Creates subsection (20) PREEXISTING CONTRACT, which provides that no funds subject to a contract or agreement existing on October 1, 2000, may be invested contrary to such contract or agreement;
- Creates subsection (21) PREEMPTION, which provides that laws, special acts, or municipal charters which prohibit or restrict local governments from complying with this statutory section (or rules adopted under this section), are void to the extent of any conflict;
- Creates subsection (22) AUDITS, which provides that audits of units of local government conducted pursuant to section 11.45, Florida Statutes, include an indication of whether or not the unit of local government has complied with this section;

- Creates subsection (23) AUDITOR GENERAL; REVIEW, which provides that during the Auditor General's review of audit reports of units of local government, the Auditor General shall notify the Joint Legislative Auditing Committee of any unit of local government not in compliance with this section. This subsection also provides procedures for the Auditor General in cases involving noncompliance; and
- Provides conforming language relative to renumbered sections and terminology.

Section 4 -- Revises section 11.45, Florida Statutes, adding provisions which authorize withholding of funds from local governmental entities, school boards, or charter schools that fail to submit certain required audit reports and authorizing the Department of Revenue and the Department of Banking and Finance to implement said provisions.

Section 5 -- Revises section 218.32, Florida Statutes, adding provisions which authorize the Department of Revenue and the Department of Banking and Finance to implement provisions which authorize the withholding of funds not pledged for satisfaction of bond debt service from local governments that fail to provide certain information regarding bonded obligations or fail to file annual financial reports.

Section 6 -- Revises section 218.38, Florida Statutes, and authorizes the Department of Revenue and the Department of Banking and Finance to implement provisions which authorize the withholding of funds from local governments that fail to provide certain information regarding bonded obligations.

Section 7 - Amends section 28.33, Florida Statutes, relating to the investment, by the clerk of the circuit court, of county funds which are in excess of those required to meet expenses.

Section 8 - Amends section 159.416(9), Florida Statutes, relating to pool financing, by replacing investments described in sections 28.33, 125.31, 166.261, 218.345, 219.075, 236.24, and Chapter 280, Florida Statutes, with the investments described in section 218.415, Florida Statutes.

Section 9 - Amends section 219.075, Florida Statutes, relating to the investment of surplus funds by county officers, by replacing named investments, and attendant procedures, with those described in section 218.415, Florida Statutes.

Section 10 - Amends section 236.24, Florida Statutes, relating to the sources of district school funds, by removing all references to investments and reinvestments, and related procedures.

Section 11 - Amends section 236.49, Florida Statutes, relating to the expenditure of the proceeds from the issue, by school districts, of bonds, by replacing investments described in section 236.24(2)(a), Florida Statutes, with investments listed in section 218.415(16), Florida Statutes.

(Note: the investments listed in section 236.24(2)(a), Florida Statutes, are being eliminated by section 7 of this bill).

Section 12 - Amends section 237.211(6)(b), Florida Statutes, relating to school board contracts for third-party administered employee fringe benefit programs, by renumbering a reference to section 230.23(10), Florida Statutes, and conforming the reference to a paragraph dealing with *protection against loss*.

Section 13 - Repeals sections 125.31, 166.261, 218.345, 230.23(10)(k), and 237.161(5), Florida Statutes.

Section 14 - Provides an effective date of October 1, 2000.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Division estimates no impact on state revenues.

2. Expenditures:

The Division estimates no impact on state expenditures.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The Division estimates no impact on local revenues.

2. Expenditures:

The Division estimates no impact on local expenditures.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The Division estimates no economic impact on the private sector.

D. FISCAL COMMENTS:

None

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

The bill does not require counties or municipalities to spend funds, or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

The bill does not reduce the authority that counties or municipalities have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

The bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

The bill relates to the investment of funds by counties and municipalities, but makes no new provisions *requiring* the expenditure of funds, only with investment or reinvestment options and attendant procedures.

B. RULE-MAKING AUTHORITY:

None

C. OTHER COMMENTS:

The Florida League of Cities has been contacted regarding the bill. At the time of publication of this analysis, no comments regarding the bill had been received.

The Florida Association of Counties has been contacted regarding the bill. However, at the time of publication of this analysis, the Association has no position on the bill.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On January 19, 2000, the House Committee on Community Affairs approved two amendments, offered by Representative Andrews, that clarifies that local governments may invest in interest-bearing time deposits or savings accounts in qualified public depositories as defined in section 280.02, Florida Statutes.

On Wednesday February 9, 2000 the Finance and Taxation Committee adopted seven additional amendments and then rolled those seven amendments along with the two amendments from Community Affairs into the Committee Substitute. The seven amendments by Finance and Taxation were:

Amendment 1: Allows chief financial officer to have the necessary expertise as an alternative to requiring that the “officials responsible for making investments decisions” have that technical knowledge.

Amendment 2: Removes language requiring that “the most economically advantageous bid” be accepted and replaces it with language specifying that the plan best meeting the specified investment objectives will be accepted.

Amendment 3: Allows the alternative of having the chief financial officer establish the system of internal controls.

Amendment 4: Specifies that the chief financial officer, rather than the “officials responsible for making investments decisions” may be designated in the investment plan to complete the required continuing education.

Amendment 5: Creates a new Section 6 which revises section 218.38, Florida Statutes, and authorizes the Department of Revenue and the Department of Banking and Finance to implement provisions which authorize the withholding of funds from local governments that fail to provide certain information regarding bonded obligations.

Amendment 6: Allows the chief financial officer to prepare the required reports.

Amendment 7: Authorizes the Department of Revenue and the Department of Banking and Finance to implement provisions which authorize the withholding of funds not pledged for satisfaction of bond debt service from local governments that fail to provide certain information regarding bonded obligations or fail to file annual financial reports.

Amendment 8: Creates a new section 5 which revises Section 218.32, Florida Statutes, adding provisions which authorize the Department of Revenue and the Department of Banking and Finance to implement provisions which authorize the withholding of funds not pledged for satisfaction of bond debt service from local governments that fail to provide certain information regarding bonded obligations or fail to file annual financial reports.

Amendment 9: Creates a new section 4 which revises Section 11.45, Florida Statutes, adding provisions which authorize withholding of funds from local governmental entities, school boards, or charter schools that fail to submit certain required audit reports and authorizing the Department of Revenue and the Department of Banking and Finance to implement said provisions.

VII. SIGNATURES:

COMMITTEE ON GOVERNMENTAL OPERATIONS:

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