

STORAGE NAME: h0303.go
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**HOUSE OF REPRESENTATIVES
COMMITTEE ON
GOVERNMENTAL OPERATIONS
ANALYSIS**

BILL #: HB 303
RELATING TO: Investment of Public Funds
SPONSOR(S): Representative Andrews
TIED BILL(S):

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

- (1) GOVERNMENTAL OPERATIONS
 - (2) COMMUNITY AFFAIRS
 - (3) FINANCE & TAXATION
 - (4) GENERAL GOVERNMENT APPROPRIATIONS
 - (5)
-

I. SUMMARY:

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. 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, F.S.;
- ▶ 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, F.S.;
- ▶ Violations of the qualification requirements provided in the Internal Revenue Code of the United States;
- ▶ Language in Chapters 175 and 185, F.S., which puts these chapter 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 board early retirement programs, and;
- ▶ The need to modify the Division's oversight responsibilities pursuant to part VII of Chapter 112, F.S.

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

This 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, F.S., and of other public funds available to units of local government.

The effective date of this bill is October 1, 2000.

This bill has 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:

Numerous statutes, including, Chapters 28, 112, 125, 159, 166, 218, 219, 236 and 237, F.S., 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, F.S., 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 (s. 215.47, F.S.). The SBA is also authorized to provide technical assistance to local governments in the investment of surplus funds.

Section 218.415, F.S., 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, F.S., 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 s. 218.415, F.S., 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 s. 218. 415(15), F.S., 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 s. 218.415(13), F.S., “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.

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

Section 112.61, F.S., 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, F.S. It has been difficult to obtain fair market values when such values are not reported.

C. EFFECT OF PROPOSED CHANGES:

This bill provides uniform guidelines for the investment of public funds by units of local government.

Section 1 - Amends definitions, and adds a definition in s. 112.625, F.S.

Part VII of Chapter 112, F.S., includes various references to "board" and "board of trustees", neither of which is defined.

Subsection (7) is amended providing 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 adding the terms "board", and "board of trustees" as designated person or persons, providing definition to the terms.

Subsection (9) adds a definition for the term "plan sponsor".

Section 2 - Creates s. 112.661, F.S.

In several annual reports, the Division noted a lack of uniform standards regarding investments of pension program funds subject to Part VII of Chapter 112, F.S. 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.

Section 2:

- ▶ 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 specified: 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.

The effect of these provisions is to provide uniform structure among plans, and to encourage pension plan policymakers to maximize financial returns. Additionally,

this bill requires and enables units of local government to more prudently manage plans.

Section 3 - Amends s. 218.415, F.S., relating to local government excess funds investment policies.

Section 3:

- ▶ Amends subsection (1) SCOPE, 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, 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, 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 (rather than the *chief financial officer*, only), must have sufficient understanding and expertise relative to such investments;
- ▶ Amends subsection (11) MASTER REPURCHASE AGREEMENT, 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, providing that the *investment policy* require staff to analyze and select investments, and competitively bid selections. Also, except as otherwise required by law, the *most economically advantageous bid* must be selected;
- ▶ Amends subsection (13) INTERNAL CONTROLS, providing that *officials responsible for making investment decisions* (rather than the *chief financial officers*), shall establish a system of internal controls;
- ▶ Renumbers subsection (14) to (15) REPORTING, and amends it, providing that the government entity's *officials responsible for making investment decisions* (rather than the *chief financial officer*), prepare certain reports;
- ▶ Creates a new subsection (14) CONTINUING EDUCATION, providing that the investment policy include relevant educational and training requirements;
- ▶ Creates subsection (16) AUTHORIZED INVESTMENTS; WRITTEN INVESTMENT POLICIES, providing 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, 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, providing for proper earmarking and handling of securities;
- ▶ Creates subsection (19) SALE OF SECURITIES, providing conditions and method of selling securities, and handling of sale proceeds;

- ▶ Creates subsection (20) **PREEXISTING CONTRACT**, providing 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**, providing 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**, providing that audits of units of local government conducted pursuant to s. 11.45, F.S., include an indication of whether or not the unit of local government has complied with this section;
- ▶ Creates subsection (23) **AUDITOR GENERAL; REVIEW**, providing 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 - Amends s. 28.33, F.S., 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 4 requires the clerk of the circuit court to invest such funds pursuant to the provisions in s. 218.415, F.S., 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 s. 218.415, F.S., the universe of investments is increased. Also, such investments, with attendant procedures and limitations, conform with those of other units of local government.

Section 5 - Amends s. 159.416(9), F.S., relating to pool financing.

Section 5 replaces investments described in ss. 28.33, 125.31, 166.261, 218.345, 219.075, 236.24, and chapter 280, F.S., with the investments described in s. 218.415, F.S.

By using the investments described in s. 218.415, F.S., rather than those formerly referred to, future pool financing investments, with attendant procedures and limitations, conform with those of other units of local government.

Section 6 - Amends s. 219.075, F.S., relating to the investment of surplus funds by county officers. Section 6 treats s. 219.075, F.S., much like Section 4 treats the investment of surplus funds by the clerk of the circuit court, by replacing named investments, and attendant procedures, with those described in s. 218.415, F.S.

By using the investments described in s. 218.415, F.S., rather than those formerly referred to, such (future) investments, with attendant procedures and limitations, conform with those of other units of local government.

Section 7 - Amends s. 236.24, F.S., relating to the sources of district school funds. All references to investments and reinvestments, and related procedures are removed.

By removing such references, the scope of s. 236.24, F.S., is limited to the *sources* of funds available for district school funds.

Section 8 - Amends s. 236.49, F.S., relating to the expenditure of the proceeds from the issue, by school districts, of bonds, replacing investments described in s. 236.24(2)(a), F.S., with investments listed in s. 218.415(16), F.S.

By using the investments described in s. 218.415(16), F.S., rather than those formerly referred to, such (future) investments, with attendant procedures and limitations, conform with those of units of local government *electing to adopt a written investment policy*.

Section 9 - Amends s. 237.211(6)(b), F.S., relating to school board contracts for third-party administered employee fringe benefit programs, renumbering a reference to s. 230.23(10), F.S., conform the reference to a paragraph dealing with *protection against loss*.

This bill repeals s. 230.23(10)(k), F.S., in Section 10. Renumbering paragraph (l), to (k) maintains the appropriate reference to language dealing with protection against loss to school property, or loss resulting from liability.

Section 10 - Repeals ss. 125.31, 166.261, 218.345, 230.23(10)(k), and 237.161(5), F.S.

▶ Section 125.31, F.S., provides requirements related to the investment of surplus county public funds by county commissioners.

Investment policy provisions in this bill supersede provisions in s. 125.31, F.S. This repeal results in the removal of superseded language from the statutes.

▶ Section 166.261, F.S., provides requirements related to the investment of surplus municipal funds by municipal governing bodies.

Investment policy provisions in this bill supersede provisions in s. 166.261, F.S. This repeal results in the removal of superseded language from the statutes.

▶ Section 218.345, F.S., provides requirements related to the investment and reinvestment of surplus special district public funds by special district governing bodies.

Investment policy provisions in this bill supersede provisions in s. 218.345, F.S. This repeal results in the removal of superseded language from the statutes.

▶ Section 230.23(10)(k), F.S., provides requirements related to the investment of surplus school district funds by school boards.

Investment policy provisions in this bill supersede provisions in s. 230.23(10)(k), F.S. This repeal results in the removal of superseded language from the statutes.

► Section 237.161(5), F.S., provides requirements related to the investment of surplus school district funds by school boards.

Investment policy provisions in this bill supersede provisions in s. 237.161(5), F.S. This repeal results in the removal of superseded language from the statutes.

Section 11 - Provides an effective date of October 1, 2000.

D. SECTION-BY-SECTION ANALYSIS:

See Section C. EFFECT OF PROPOSED CHANGES.

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:

This 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:

This 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:

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

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

This 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:

None.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

None

VII. SIGNATURES:

COMMITTEE ON GOVERNMENTAL OPERATIONS:

Prepared by:

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