The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Governmental Oversight and Accountability

BILL: CS/SB 534

INTRODUCER: Committee on Governmental Oversight and Accountability and Senator Brandes

SUBJECT: Public Defined Benefit Pension Plans

DATE: March 7, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McKay	McVaney	GO	**Fav/CS**
2.			CA	
3.			AP	
4.				
5.				
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	X	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

I. Summary:

CS/SB 534 explicitly provides that the state is not liable for any obligation relating to any financial shortfalls in any local government retirement plan. The bill also specifies additional reporting requirements for public pension plans, and provides that local plans which do not comply with the reporting requirements may jeopardize their revenue sharing funds.

This bill substantially amends sections 112.66 and 112.665 of the Florida Statutes, and creates section 112.664.

II. Present Situation:

Florida Local Retirement Systems and Plans

The Division of Retirement of the Department of Management Services (DMS) reports[1] that as of September 30, 2012, there are 492 defined benefit plans sponsored by 249 local governments in Florida. The vast majority of the plans, 486, are local government defined benefit systems that

[1] Division of Management Services, *Florida Local Government Retirement Systems*, 2012 Annual Report, available online at: https://www.rol.frs.state.fl.us/forms/2012_Local_Report.pdf (last visited on February 11, 2013).

provide benefits to 77,331 retirees, with 102,636 active employees, and total plan assets of $23.8 billion.[2] The average annual pension in these local defined benefit plans is $25,109, and the average annual required contribution rate as a percentage of payroll is 29.62 percent. The total unfunded actuarial accrued liability for all the defined benefit plans as of September 30, 2012, was $10 billion.

Actuarial Reporting for Public Pension Plans

Section 112.63, F.S., requires that public pension plans funded in whole or part by public plans must have regularly scheduled actuarial reports prepared and certified by an enrolled actuary, at least every three years. The actuarial reports must include at least the following information:
- Adequacy of employer and employee contributions;
- A plan to amortize any unfunded liability, and a description of actions taken to reduce the unfunded liability;
- A description and explanation of actuarial assumptions;
- A schedule illustrating the amortization of unfunded liabilities, if any;
- A comparative review illustrating the actual salary increases granted and the rate of investment return realized over the 3-year period preceding the actuarial report with the assumptions used in both the preceding and current actuarial reports;
- A disclosure of the present value of the plan's accrued vested, nonvested, and total benefits, as adopted by the Financial Accounting Standards Board, using the Florida Retirement System's assumed rate of return; and
- A statement by the enrolled actuary that the report is complete and accurate and that the techniques and assumptions used are reasonable and meet the requirements of state law.

The actuarial cost methods used to establish the annual normal costs of the plans must be those methods approved in the Employee Retirement Income Security Act of 1974.

The actuarial reports must be submitted to the Department of Management Services, which must review the reports to determine whether the actuarial valuation is complete, accurate, or based on reasonable assumptions.[3]

Firefighter and Police Pension Plans

Sections 175.261 and 185.221, F.S., specify the financial reporting requirements for firefighter and municipal police pensions, respectively, which generally require an annual independent audit, and an actuarial valuation every three years. The reports must be submitted to DMS' Division of Retirement, which issues an annual report to the Legislature based upon the reporting from the plans.

Sections 175.051 and 85.04, F.S., state, in pertinent part, that actuarial deficits, if any, arising under plans under chapters 175 or 185, shall not be the obligation of the state.

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[2] The other 6 plans are school board early retirement programs that provide benefits to 1,644 retirees, with active plan membership of 8,631, and total plan assets of $63.7 million.
[3] Section 112.63(4)(a), F.S.

Generally Accepted Accounting Principles

The Governmental Accounting Standards Board (GASB) is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. GASB was established in 1984 by agreement of the Financial Accounting Foundation and 10 national associations of state and local government officials. GASB is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles for state and local governments.[4]

In June of 2012, GASB released Statement No. 67, *Financial Reporting for Pension Plans*, which establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the pension liability of employers and nonemployer contributing entities for benefits provided through the pension plan (the net pension liability), about which information is required to be presented. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. [5] The new Statements relate to accounting and financial reporting issues only—how pension costs and obligations are measured and reported in audited external financial reports. The Statements do not address how governments approach pension plan funding—a government's policy regarding how much money it will contribute to its pension plan each year.[6]

Actuarial Soundness and Minimum Funding Standards for Pensions

Article X, s. 14, of the State Constitution requires public retirement benefits to be funded on a sound actuarial basis:

> SECTION 14: State retirement systems benefit changes.- A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not after January 1, 1977, provide any increase in the benefits to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis.[7]

The "Florida Protection of Public Employee Retirement Benefits Act" located in part VII of ch. 112, F.S., provides minimum operation and funding standards for public employee retirement plans. The legislative intent of this act is to "prohibit the use of any procedure, methodology, or

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[4] From "Facts About GASB," available at http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824305999&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs (last visited on February 11, 2013).
[5] Summary of Statement No. 67, available at http://www.gasb.org/cs/ContentServer?c=Pronouncement_C&pagename=GASB/Pronouncement_C/GASBSummaryPage&cid=1176160219444 (last visited on February 14, 2013).
[6] New GASB Pension Statements to Bring about Major Improvements in Financial Reporting, a June 2012 publication by GASB, available at http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175824124337&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs (last visited on February 18, 2013).
[7] Art. X, section 14 of the Florida Constitution.

assumptions, the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers."[8]

Internal Revenue Code Section 430: Minimum Funding Standards for Single-Employer Defined Benefit Pension Plans

For actuarial determinations made pursuant to Section 430 of the Internal Revenue Code, the interest rate used in determining the present value of the liabilities of the plan must be a segmented corporate bond yield curve. The first segment consists of benefits reasonably determined to be payable during the 5-year period beginning on the first day of the plan year; the second segment consists of benefits reasonably determined to be payable between 5 and 20 years; and the third segment rate is benefits reasonably determined to be payable after 20 years.[9]

The table below[10] lists the 24-month average segment rates without adjustment for the applicable percentages of the 25-year average segment rates, and lists the 24-month average segment rates as adjusted by the applicable maximum and applicable minimum percentages of the 25-year average segment rates.

Funding Table 3							
For Plan Years Beginning In		24-Month Average Segment Rates Not Adjusted			Adjusted 24-Month Average Segment Rates, Based on Applicable Percentage of 25-Year Average Rates		
	Applicable Month	First Segment	Second Segment	Third Segment	First Segment	Second Segment	Third Segment
2013	Feb-13	1.58	4.34	5.38	4.94	6.15	6.76
2013	Jan-13	1.62	4.40	5.45	4.94	6.15	6.76
2013	Dec-12	1.66	4.47	5.52	4.94	6.15	6.76
2013	Nov-12	1.69	4.53	5.60	4.94	6.15	6.76
2013	Oct-12	1.72	4.58	5.67	4.94	6.15	6.76
2013	Sep-12	1.75	4.62	5.72	4.94	6.15	6.76
	Applicable Month	First Segment	Second Segment	Third Segment	First Segment	Second Segment	Third Segment
2012	Feb-13	1.58	4.34	5.38	5.54	6.85	7.52
2012	Jan-13	1.62	4.40	5.45	5.54	6.85	7.52
2012	Dec-12	1.66	4.47	5.52	5.54	6.85	7.52
2012	Nov-12	1.69	4.53	5.60	5.54	6.85	7.52
2012	Oct-12	1.72	4.58	5.67	5.54	6.85	7.52
2012	Sep-12	1.75	4.62	5.72	5.54	6.85	7.52
2012	Aug-12	1.77	4.67	5.78	5.54	6.85	7.52
2012	Jul-12	1.81	4.73	5.85	5.54	6.85	7.52
2012	Jun-12	1.84	4.79	5.90	5.54	6.85	7.52
2012	May-12	1.87	4.84	5.96	5.54	6.85	7.52
2012	Apr-12	1.90	4.90	6.01	5.54	6.85	7.52
2012	Mar-12	1.93	4.95	6.07	5.54	6.85	7.52
2012	Feb-12	1.96	5.01	6.13	5.54	6.85	7.52
2012	Jan-12	1.98	5.07	6.19	5.54	6.85	7.52

[8] Section 112.61, F.S.
[9] Section 430(h)(2)(C) of the Internal Revenue Code.
[10] This table is taken from Funding Yield Curve Segment Rates, available at http://www.irs.gov/Retirement-Plans/Funding-Yield-Curve-Segment-Rates (last visited February 15, 2013).

	Applicable Month	First Segment	Second Segment	Third Segment	First Segment	Second Segment	Third Segment
2012	Dec-11	1.99	5.12	6.24	5.54	6.85	7.52
2012	Nov-11	2.01	5.16	6.28	5.54	6.85	7.52
2012	Oct-11	2.03	5.20	6.30	5.54	6.85	7.52
2012	Sep-11	2.06	5.25	6.32	5.54	6.85	7.52

Section 430(h)(3) of the Internal Revenue Code also provides that the Secretary must by regulation prescribe mortality tables to be used in determining any present value or making any computation under section 430 of the Code, implemented as the RP-2000 Mortality Tables.

III. Effect of Proposed Changes:

Section 1 amends s. 112.66, F.S., to specify that the state is not liable for any obligation relating to any current or future shortfall in any local government retirement system or plan.

Section 2 creates s. 112.664, F.S., requiring additional reporting requirements for all publicly-funded defined benefit retirement plans. The following information must be provided to DMS yearly, within 180 days after the close of the first plan year that ends after June 30, 2013, and thereafter in each year in which an actuarial valuation of the plan is done:

- The long-term funded ratio calculated in a manner similar to the Government Accounting Standards Board's Statement No. 67, Financial Reporting for Pension Plans, including the market value of its assets, the value of its actuarial liabilities, and the amount of its unfunded accrued liability, if any.
- The dollar value of the unfunded accrued liability, if any, of the plan.
- The number of months or years for which the current market value of assets are adequate to sustain the payment of expected retirement benefits.
- The recommended contributions to the plan under GASB No. 67 calculations, stated as an annual dollar value and a percentage of valuation payroll.

To determine the information above, each reporting plan must use the following assumptions and methods:

- The actuarial cost method must be the Entry Age Normal method.
- The assumed rate of return on investments and the assumed discount rate must be the adjusted 24-month average corporate bond segment rates determined under s. 430(h)(2)(C)(iv) of the Internal Revenue Code by the Department of the Treasury.
- Preretirement mortality must be calculated using the RP-2000 Mortality Tables for male and female employees which accounts for generational mortality improvements. Postretirement mortality must be calculated using the RP-2000 Mortality Tables for healthy white-collar employees, as projected from the year 2000 to the valuation year using Projection Scale AA.
- The asset valuation method must be the market value less the value of any deferred retirement option program accounts.
- The actuarial accrued liabilities, excluding the value of any deferred retirement option program accounts
- All other assumptions and methods must be those used by the system or plan in its latest valuation.

Though it is a reporting requirement and not a funding requirement, the corporate bond assumed discount rate may produce lower funded ratios for most plans, since in the actuarial reporting the plans are currently doing, the average assumed rate of return for local plans is approximately 7.7%.[11]

The information required by this bill must be provided by local government plan sponsors and the plans in the municipal budget disclosure required by s. 166.241(3), F.S., and on any websites that contain budget information, or actuarial or plan performance information. Each plan sponsor and plan that has a publically available website must also provide the plan's most recent financial statement and actuarial valuation on the website.

Plans that fail to timely submit the required information within 30 days after receipt of the plans actuarial report will be deemed to be in noncompliance. DMS may notify the Department of Revenue (DOR) and Department of Financial Services (DFS) of the noncompliance, and DOR and DFS must withhold funds payable to the plan sponsor which are not pledged towards bond debt service. The bill gives plan sponsors administrative rights if these actions are taken.

Section 3 amends s. 112.665, F.S., to mandate that the DMS-produced local pension plan fact sheets must contain the additional reporting information required by this bill.

Section 4 is the legislative finding of an important state interest.

The bill takes effect July 1, 2013.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

To the extent this bill requires a local government to expend funds to comply with its terms, the provisions of section 18(a) of Article VII of the State Constitution may apply. If those provisions do apply, in order for the law to be binding upon the cities and counties, the Legislature must find that the law fulfills an important state interest, and one of the following relevant exceptions must apply:

- Funds estimated at the time of enactment sufficient to fund such expenditures are appropriated;
- Counties and cities are authorized to enact a funding source not available for such local government on February 1, 1989, that can be used to generate the amount of funds necessary to fund the expenditures;
- The expenditure is required to comply with a law that applies to all persons similarly situated; or
- The law must be approved by two-thirds of the membership of each house of the Legislature.

[11] Using data from the July 1, 2010 actuarial valuation of the FRS, a study was done in March 2011, to estimate the impact of changing the FRS investment return assumptions. The actuarial liability of the FRS was $134.2 billion; the investment return rate assumption was (and still is) 7.75%. The study found that changing the investment return assumption from 7.75% to 6% would increase actuarial liabilities by $36 billion; changing it to 5% would increase actuarial liabilities by $62.9 billion. Study available at http://www.floridahasarighttoknow.com/docs/StatePensionActuaryLetter.pdf, (last visited on February 18, 2013).

Subsection (d) of Section (18) provides an exemption for general laws having an insignificant fiscal impact. Laws determined to have an "insignificant fiscal impact," means an amount not greater than the average statewide population for the applicable fiscal year times $0.10, which equates to approximately $1.9 million.

The bill contains provisions that may require expenditures applicable to all public sector pension plans in Florida. The bill contains a finding of important state interest.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

The bill requires additional reporting requirements for local plans, which may incur additional costs in producing the required reporting. The exact cost of compliance with this bill is indeterminate, though last year DMS estimated that the cost of compliance for a local pension financial rating plan proposal that involved some similar reporting requirements could range from $1,000 to $5,000 per plan, per year.[12]

According to the Department of Management Services (department), the original filed version of the bill would increase administrative costs to the Division of Retirement (division), including staff and actuarial work, to comply with the reporting requirements in the bill. According to the department's bill analysis, it estimates that the fiscal impact would be as follows:[13]

The new disclosure requirements do not affect the actuarial contributions for funding purposes for the FRS; however, there will be an administrative cost associated with preparing the new disclosures. The consulting actuary estimates that the additional

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[12] Financial Rating of Local Government Defined Benefit Plans, January 25, 2012, by the Department of Management Services, on file with the Senate Governmental Oversight and Accountability Committee.
[13] Department of Management Services, Bill Analysis 2013, for SB 534/HB 599, dated February 8, 2013, on file with the Governmental Oversight and Accountability Committee.

reporting requirement would cost about $20,000 in the first year and $10,000 in each subsequent year.

Expenditures	FY 2013-14 Amount/FTE	FY 2014-15 Amount/FTE	FY 2015-16 Amount/FTE
Recurring	$20,000	$10,000	$10,000
Non-recurring	-	-	-

In addition, one additional government analyst position would be required to insure that implementing and maintaining the actuarial database with these additional disclosure items does not negatively impact the timely accomplishment of current statutory responsibilities.

Expenditures	FY 2013-14 Amount/FTE	FY 2014-15 Amount/FTE	FY 2015-16 Amount/FTE
Recurring	$57,693	$57,693	$57,693
Non-recurring	$3,762	-	-

Additionally, the actuarial costs for the chapter plans under chapters 175 and 185, F.S., are paid for from the police and firefighter's trust fund.[14] The bill creates an additional annual expenditure requirement for reporting in order to qualify for premium tax distributions.

Expenditures	FY 2013-14 Amount/FTE	FY 2014-15 Amount/FTE	FY 2015-16 Amount/FTE
Recurring	$30,000	$20,000	$20,000
Non-recurring	-	-	-

VI. Technical Deficiencies:

None.

VII. Related Issues:

On March 7, 1013, the Committee on Governmental Oversight and Accountability adopted two hand-written amendments (barcodes 592460 and 784588), now in CS/SB 534, which were intended to remove the Florida Retirement System from the provisions of the bill. Though the amendments physically removed references to the FRS from the bill, the reporting requirements of the bill are placed in Part VII of chapter 112, F.S., which applies to defined benefit systems or plans supported in part or whole by public funds, which includes the FRS. The Legislature should explicitly exclude the FRS from the bill's requirements, if that is the intent of the Legislature.

[14] The division conducts the actuarial valuations of chapter plans. *See* ss. 175.032(2) and 185.02(3), F.S.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS/SB 534 by Governmental Oversight and Accountability on March 7, 2013:
The proposed committee substitute makes the following changes to the bill:
- Adds a finding of important state interest;
- Clarifies that the mortality tables must account for generational mortality improvements;
- Excludes Deferred Retirement Option Program (DROP) assets and liabilities from the calculations;
- Provides that all plans must report for the first plan year ending on or after June 30, 2013, and in each subsequent year in which an actuarial valuation is completed;
- Provides that plans that do not comply with the reporting requirements may have their revenue sharing withheld, and specifies administrative procedures; and
- Requires that the yearly local plan fact sheets produced by the DMS must include the additional reporting requirements.

B. Amendments:

None.