HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 603 Publicly Funded Defined Benefit Retirement Plans
SPONSOR(S): Oversight, Transparency & Administration Subcommittee; Fischer
TIED BILLS: **IDEN./SIM. BILLS:** SB 632

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Oversight, Transparency & Administration Subcommittee	9 Y, 5 N, As CS	Moore	Harrington
2) Appropriations Committee			
3) Government Accountability Committee			

SUMMARY ANALYSIS

The State Constitution provides that a governmental unit responsible for a retirement or pension system supported wholly or partially by public pension funds may not, after January 1, 1977, provide an increase in benefits to members or beneficiaries without concurrent provisions for funding the increase on a sound actuarial basis. Funding a pension benefit requires the use of projections, known as actuarial assumptions, about future events. As with other actuarial assumptions, projecting pension fund investment returns requires a focus on the long-term.

The bill defines the term “long-range return rate” to mean an actuarial assumed rate of return that is expected to be realized at least 50 percent of the time over the next 30-year period.

The bill requires a public pension plan’s triennial actuarial report to include the plan’s long-range return rate. If a plan has an actuarial assumed rate of return greater than the long-range return rate, the report must also include:

- The difference between the plan’s actuarial assumed rate of return and long-range return rate.
- A description of actions taken to reduce the actuarial assumed rate of return.
- Any change to the plan investment strategy, including, but not limited to, changes to asset class allocations, and any change to actuarial methodology which results in a change to either the long-range return rate or the actuarial assumed rate of return of the plan.
- An estimate of the additional cost to the plan or system that would result if the plan used the long-range return rate as the plan’s actuarial assumed rate of return.

The bill does not appear to have a fiscal impact on the state or local governments.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background

State Constitution Requirements
Section 14, Art. X of the State Constitution provides that a governmental unit responsible for a retirement or pension system supported wholly or partially by public pension funds may not, after January 1, 1977, provide an increase in benefits to members or beneficiaries without concurrent provisions for funding the increase on a sound actuarial basis.

The Florida Protection of Public Employee Retirement Benefits Act
Part VII of chapter 112, F.S., the Florida Protection of Public Employee Retirement Benefits Act (act) was adopted by the Legislature to implement the provisions of s. 14, Art. X of the State Constitution. The act establishes minimum standards for operating and funding public employee retirement systems and plans. It is applicable to all units of state, county, special district, and municipal governments participating in, operating, or administering a retirement system for public employees, which is funded in whole or in part by public funds.[1] Responsibility for administration of the act has been assigned primarily to the Department of Management Services (department), Division of Retirement (division).

Florida Retirement System
The Florida Retirement System (FRS) is a multiple-employer, contributory plan[2] governed by the Florida Retirement System Act.[3] As of June 30, 2016, the FRS provides retirement income benefits to 630,350 active members, 394,907 retired members and beneficiaries, and 29,602 members of the Deferred Retirement Option Program.[4] It is the primary retirement plan for employees of state and county government agencies, district school boards, state colleges, and universities. The FRS also serves as the retirement plan for participating employees of the 173 cities and 260 special districts that have elected to join the system. Members of the FRS have two primary plan options available for participation:

- The pension plan, which is a defined benefit plan;[5] and
- The investment plan, which is a defined contribution plan.[6]

Local Government Retirement Systems and Plans
The division reports that as of September 30, 2016, there are 489 defined benefit plans sponsored by 247 local governments.[7] The vast majority of the plans, 483, are local government defined benefit systems that provide benefits to 90,994 retirees and have 95,182 active employees and total plan assets of $35.9 billion. The average annual pension in these local plans is $27,414, and the average annual required contribution rate as a percentage of payroll is 33.28 percent.[8]

A unit of local government may not agree to a proposed change in retirement benefits unless the administrator of the system, prior to adoption of the change by the governing body and prior to the last

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[1] Section 112.62, F.S.
[2] Prior to 1975, members of the FRS were required to make employee contributions of either 4 percent for Regular Class members or 6 percent for Special Risk Class members. Members were again required to contribute to the system after June 30, 2011.
[3] Chapter 121, F.S.
[4] *Florida Retirement System Pension Plan And Other State Administered Systems Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2016*, at 6, *available at* http://www.dms.myflorida.com/workforce_operations/retirement/publications/annual_reports.
[5] As of June 30, 2016, the pension plan had 515,916 members. *Id.*at 120.
[6] As of June 30, 2016, the investment plan had 114,434 members. *Id.*
[7] Department of Management Services, *Florida Local Government Retirement Systems*, 2016 Annual Report, p. 4, *available at* https://www.rol.frs.state.fl.us/forms/2016_Local_Report.pdf.
[8] *Id.*

public hearing thereon, has issued a statement of the actuarial impact of the proposed change upon the local retirement system and furnished a copy of such statement to the division.[9] In addition, the statement is required to indicate whether the proposed changes are in compliance with s. 14, Art. X of the State Constitution and with s. 112.64, F.S., which relates to administration of funds and amortization of unfunded liability.

Public Pension Plan Investment Return Assumptions

Funding a pension benefit requires the use of projections, known as actuarial assumptions, about future events. Actuarial assumptions fall into one of two broad categories: demographic and economic. Demographic assumptions are those pertaining to a pension plan's membership, such as changes in the number of working and retired plan participants, when participants will retire, and how long they'll live after they retire. Economic assumptions pertain to such factors as the rate of wage growth and the future expected investment return on the fund's assets. As with other actuarial assumptions, projecting pension fund investment returns requires a focus on the long-term.[10]

Because investment earnings account for a majority of revenue for a typical public pension fund, the accuracy of the return assumption has a major effect on a plan's finances and actuarial funding level. An investment return assumption that is set too low will overstate liabilities and costs, causing current taxpayers to be overcharged and future taxpayers to be undercharged. A rate set too high will understate liabilities, undercharging current taxpayers at the expense of future taxpayers. An assumption that is significantly wrong in either direction will cause a misallocation of resources and unfairly distribute costs among generations of taxpayers.[11]

Amortization of Unfunded Liability

Section 112.64, F.S., governs the amortization of unfunded liability for public employee retirement systems or plans. For those plans in existence on October 1, 1980, the total contributions to the retirement system or plan must be sufficient to meet the normal cost of the retirement system or plan and to amortize the unfunded liability, if any, within 40 years; however, this requirement does not permit a retirement system or plan to amortize its unfunded liabilities over a period longer than that which remains under its current amortization schedule.[12] For a retirement system or plan that comes into existence after October 1, 1980, the unfunded liability, if any, must be amortized within 40 years of the first plan year.[13] The net increase, if any, in unfunded liability under the plan arising from significant plan amendments adopted, changes in actuarial assumptions, changes in funding methods, or actuarial gains or losses must be amortized within 30 plan years.[14]

Reporting Requirements for Publicly-Funded Retirement Plans

To help ensure that each retirement system or plan maintains funding of retirement systems at an appropriate level, governmental entities are required to submit regularly scheduled actuarial reports to the division for its review and approval.[15]

Section 112.63, F.S., requires the plan administrators for all publicly-funded pension plans to submit an actuarial report at least every three years and requires the actuarial reports to consist of, but not be limited to, the following information:

- Adequacy of employer and employee contribution rates in meeting levels of employee benefits and changes, if any, needed in such rates to achieve or preserve a level of funding deemed adequate to enable payment through the indefinite future of the benefit amounts prescribed by the system;

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[9] *See* s. 112.63, F.S.
[10] *NASRA Issue Brief: Public Pension Plan Investment Return Assumptions*, National Association of State Retirement Administrators, p. 1, February 2017, *available at* http://www.nasra.org/files/Issue%20Briefs/NASRAInvReturnAssumptBrief.pdf.
[11] *Id.*
[12] Section 112.62, F.S.
[13] Section 112.63, F.S.
[14] Section 112.64, F.S.
[15] Section 112.63(1), F.S., requires an enrolled actuary to certify the scheduled actuarial reports.

- A plan to amortize any unfunded liability pursuant to s. 112.64, F.S., 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;
- Effective January 1, 2016, the mortality tables used in either of the two most recently published actuarial valuation reports of the Florida Retirement System, including the projection scale for mortality improvement; and
- A statement by the enrolled actuary that the report is complete and accurate and that, in his or her opinion, the techniques and assumptions used are reasonable and meet the requirements and intent of the act.

The actuarial cost methods utilized for establishing the amount of the annual actuarial normal cost to support the promised benefits must only be those methods approved in the Employee Retirement Income Security Act of 1974 and as permitted under regulations prescribed by the Secretary of the Treasury.[16]

If the division determines that a governmental entity has not submitted a complete, accurate, or reasonable actuarial valuation or required reports, the division must notify the plan administrator of the deficiency and request an appropriate adjustment or the required information.[17] If after a reasonable period of time, a satisfactory adjustment has not been made, or the required report has not been provided, the department may notify DOR and the Department of Financial Services of the noncompliance and those agencies must withhold any funds not pledged for satisfaction of bonds until such adjustment is made to the report.[18] The affected governmental entity may petition the department for a hearing.[19]

Effect of the Bill

The bill defines the term “long-range return rate” to mean an actuarial assumed rate of return that is expected to be realized at least 50 percent of the time over the next 30-year period.

The bill requires a public pension plan’s triennial actuarial report to include the plan’s long-range return rate. If a plan has an actuarial assumed rate of return greater than the long-range return rate, the report must also include:
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The bill specifies that it fulfills an important state interest because it extends to employees and retirees of the state and its political subdivisions, and their families, the basic protections afforded by governmental retirement systems that provide fair and adequate benefits and that are managed, administered, and funded in an actuarially sound manner.

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[16] *Id.*
[17] Section 112.63(4)(a), F.S.
[18] Section 112.63(4)(b), F.S.
[19] Section 112.63(4)(c), F.S.

B. SECTION DIRECTORY:

Section 1. amends s. 112.625, F.S., relating to definitions.

Section 2. amends s. 112.63, F.S., relating to actuarial reports and statements of actuarial impact.

Sections 3. and 4. amend ss. 175.261 and 185.221, F.S., to conform cross-references.

Section 5. provides that the act fulfills an important state interest.

Section 6. provides an effective date of July 1, 2017.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The bill does not appear to have an impact on state government revenues.

2. Expenditures:

   The bill requires additional information to be included in the actuarial report that a public pension plan is required to submit under current law. As such, the bill does not appear to have an impact on state government expenditures.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   The bill does not appear to have an impact on local government revenues.

2. Expenditures:

   The bill requires additional information to be included in the actuarial report that a public pension plan is required to submit under current law. As such, the bill does not appear to have an impact on local government expenditures.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not applicable. The bill does not appear to require counties or municipalities to spend funds or take action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill does not appear to create a need for rulemaking or rulemaking authority.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On March 28, 2017, the Oversight, Transparency & Administration Subcommittee adopted an amendment and reported the bill favorably as a committee substitute. The amendment:

- Removed the provision prohibiting a public pension plan from having an actuarial assumed rate of return greater than the plan's long-range return rate; and
- Revised the additional information that must be included in a public pension plan's triennial actuarial report.

This analysis is drafted to the committee substitute as approved by the Oversight, Transparency & Administration Subcommittee.