SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 372

SPONSOR: Governmental Oversight and Productivity Committee and Senator Rossin

SUBJECT: Investment of Public Funds

DATE: February 10, 2000 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	Favorable/CS
2.			FP	
3.				
4.				
5.				

I. Summary:

The committee substitute provides uniform guidelines for investment of public funds by school districts, counties, municipalities and special districts. The bill creates investment policy guidelines for the investment of the assets of retirement plans subject to ch. 112, Florida Statutes.

The bill amends sections 112.625, 218.415, 11.45, 218.32, 218.38, 28.33, 219.075, 159.416, 236.24, 236.49, 237.211, Florida Statutes.

The bill creates section 112.661, F.S.

The bill repeals sections 125.31, 166.261, 218.345, 230.23(10)(k), and 237.161(5), Florida Statutes.

II. Present Situation:

Counties, cities, special districts, county officers, and district school boards are authorized to invest surplus public funds under the authority granted by ss. 125.31, 166.261, 218.345, 219.075, and 236.24, F.S. The Local Government Surplus Funds Trust Fund serves as one of the available investment options for these types of funds. Other investment options include: obligations backed by the unconditional guarantee of the United States Government; interest-bearing time deposits in banks organized under the state or the United States; obligations of the Federal Farm Credit Banks or Federal Home Loan Mortgage Corporation; and specified types of securities fully collateralized by United States Government obligations.

Part IV of ch. 218, F.S., the "Investment of Local Government Surplus Funds Act," creates the Local Government Surplus Funds Trust Fund and permits it to serve as a repository for surplus funds deposited by units of local government. The fund is administered and managed by the State Board of Administration (SBA) and is subject to the same investment restrictions as set forth in

s. 215.47, F.S. The SBA uses the same statutory authority to invest funds of the Florida Retirement System.

Section 218.415, F.S., requires that investment activity by a unit of local government must be consistent with a written investment plan or policy adopted by the governing body or principal officer for surplus funds. The plan must provide for liquidity, preservation of capital, and diversity and investments must be selected from a preauthorized list of security issues, issuers, and maturities. Alternatively, units of local government without an investment plan are limited to the following investments:

- 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.
- Federal agencies and instrumentalities.[1]

In addition, a unit of local government investment plan or policy must contain certain other elements that include:

- 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.

On July 16, 1998, the Auditor General issued a survey of local government implementation of s. 218.415, F.S. Based on the survey results, the report concluded that "many local governments have not fully complied with the requirements set forth in s. 218.415. F.S." With respect to local governments which limit their investment activities to those investment options listed in s. 218.415(15), F.S., the report found that these local governments not only unnecessarily limited

[1] "Federal agencies and instrumentalities" include all securities issued by agencies of the federal government or corporations created by Congress, e.g., obligations of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, etc.

their investment options, but also did not benefit from the investment safeguards afforded by a written investment policy.

However, in its review of local governments with an adopted investment policy, the survey results indicated that not all local governments followed their own investment policy. Specifically, the Auditor General's report found 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.

Sections 125.31, 219.075, 166.261, 218.345, and 236.24, F.S., which pertain to counties, municipalities, special districts, and school boards, respectively, impose investment requirements on these local governments that are sometimes inconsistent with, or duplicate the requirements of s. 218.415, F.S.

III. Effect of Proposed Changes:

Section 1. Amends s. 112.625, F.S., clarifying that under the definition of "Statement value" assets for which a fair market value is not provided will be excluded from the assets used in determining the annual funding cost of retirement plans; that under the definition of "fiduciary," "board" or "board of trustees" is synonymous; and that "plan sponsor" means the local governmental entity that has established or may establish a local retirement system or plan.

Section 2. Creates s. 112.661, F.S., to define an investment policy for retirement systems governed by ch. 112, F.S. The investment plan must contain many of the same elements as the investment plans authorized by s. 218.415, F.S. However, the retirement system investment policies must address seventeen specific elements:

- SCOPE: The policy shall extend to funds under control of the board.

- INVESTMENT OBJECTIVES: The investment authority shall describe the investing authority's objectives.

- PERFORMANCE MEASUREMENT: The measures used to gauge performance relative to the size and composition of the invested assets.

- INVESTMENT AND FIDUCIARY STANDARDS: A description of fiduciary standards, including a requirement that the board comply with fiduciary standards set forth in the Employee Retirement Income Security Act of 1974.

- AUTHORIZED INVESTMENTS: A listing of the authorized investments by investment policy which are subject to the investment limitations and conditions of ss. 215.47(1), (2), (3), (4), (5), (6), (7), (8), (10), and (16), F.S. Noncompliant assets can be disposed of in an economically feasible manner unless departures from the policy are permitted by either law or ordinance.

- MATURITY AND LIQUIDITY: Provisions for liquidity by matching investment maturities with anticipated cash flow requirements.
- PORTFOLIO COMPOSITION: The investment policy shall establish limitations on issuers and maturities consistent with the size of the invested funds.
- RISK AND DIVERSIFICATION: The investment policy shall address policies designed to minimize the risk of loss through investment or issuer concentration.
- EXPECTED ANNUAL RATE OF RETURN: For each actuarial valuation, a determination of the total expected annual, short and long term rate of return, and a requirement that the plan be filed with the Division of Retirement and the plan's sponsor.
- THIRD PARTY CUSTODIAL AGREEMENTS: Investment board assets should be held by a third party with sufficient safeguards to assure the availability of the security at the conclusion of the transaction.
- MASTER REPURCHASE AGREEMENTS: All agreements affecting the repurchase of securities shall adhere to the master policy adopted by the board.
- BID REQUIREMENT: That investment maturity dates of securities best match cash flow needs and consider market conditions. Those securities deemed as appropriate should then be competitively bid and the most economically advantageous bid must be selected.
- INTERNAL CONTROLS: The investment policy shall provide for an internal system of operation and external review by appropriate auditors and the board's unit of local government to minimize the risk of loss.
- CONTINUING EDUCATION: Board members shall be continually educated on matters affecting their responsibilities.
- REPORTING: Periodic and publicly accessible reports shall be provided on investment activity on at least an annual basis.
- FILING OF INVESTMENT POLICY: An adopted investment policy shall be filed with the Department of Management Services and the plan's sponsor.
- VALUATION OF ILLIQUID INVESTMENTS: For each actuarial valuation the board must verify the fair-market value of illiquid investments for which there is no recognized market or pricing mechanism.

Section 3. Amends s. 218.415, F.S., to modify the requirements for an investment plan to be developed by a unit of local government and changes the list of authorized investments for units of local governments that elect not to adopt a written investment policy, as follows:

Investment Policy

- The bill repeals the inapplicability of trust funds to the scope of investment policy subject to the investment policy in s. 218.415, F.S.
- The bill prohibits investments that have not been preauthorized and listed in the investment policy (for those units of local government that elect to adopt a policy).
- If the investment policy authorizes investments in derivative products, the bill requires officials responsible for making investment decisions to have sufficient expertise to manage them.
- If used, reverse repurchase agreements must be listed in the investment policy and may only be used for purposes of providing liquidity.
- The investment policy requires that investment maturity dates of securities best match cash flow needs and consider market conditions. Those securities deemed as appropriate should then be competitively bid and the most economically advantageous bid must be selected.
- The investment policy must provide for 8 hours of continuing education annually for local government officials responsible for making investment decisions.

Local government units with a written investment plan are authorized to invest surplus funds in the following:

- The Local Government Surplus Funds Trust Fund.
- Securities and Exchange Commission registered money market funds.
- Savings accounts or certificates of deposits in banks and savings and loan associations.
- Direct obligations of the United States Treasury.
- Securities registered under the Investment Company Act of 1940, as amended, under certain conditions.

Local government units without a written investment plan are authorized to invest surplus funds in all of the above except securities registered under the Investment Company Act of 1940.

Securities

The bill includes a set of safekeeping procedures for local governments to follow regarding purchased securities and provides that the governing body of the unit of local government may receive bank trust receipts in return for investment of surplus funds in securities. In addition, the section authorizes the governing body of the unit of local government to sell the security at the prevailing market rate and to deposit the proceeds of the sale into the proper account of the unit of local government.

Audits

The bill provides that certified public accountants conducting audits of units of local government pursuant to s. 11.45, F.S., are required to review whether the local government has complied with the investment policy requirements of s. 218.415, F.S. The Auditor General is required to notify the Joint Legislative Auditing Committee of any unit of local government that does not comply with the investment policy requirements of s. 218.415, F.S. Any governmental entity not in compliance with the provisions of s. 218.415, F.S., may be subject to the withholding of payment of funds. In the case of a special district the committee shall notify the Department of Community Affairs for consideration of actions; in the case of counties, municipalities, and district school boards, the committee shall notify the Department of Revenue and the Department of Banking and Finance.

Section 4. Amends s. 11.45(3)(a)1., F.S., to authorize the Legislative Auditing Committee to request the Department of Revenue and the Department of Banking and Finance to withhold any funds not pledged for bond debt service satisfaction which are payable to the governmental entity or charter school until the required financial audit is received by the Auditor General. Authorizes the Department of Revenue and the Department of Banking and Finance to implement the provisions of the paragraph.

Section 5. Amends s. 218.32(1)(e), F.S., to authorize the Legislative Auditing Committee to request the Department of Revenue and the Department of Banking and Finance to withhold any funds not pledged for bond debt service satisfaction which are payable to the governmental entity or charter school until the required financial audit is received by the Auditor General. Authorizes the Department of Revenue and the Department of Banking and Finance to implement the provisions of the paragraph.

Section 6. Amends s. 218.38(3), F.S., to authorize the Department of Revenue and the Department of Banking and Finance to implement the provisions of the paragraph.

Section 7. Amends s. 28.33, F.S., to provide that the investment of surplus funds of the clerk of the court must be invested as described in s. 218.415, F.S.

Section 8. Amends s. 159.416(9), F.S., to authorize the investment of bond proceeds and money held for the payment of debt service on bonds to be invested as provided in s. 218.415, F.S., for purposes of pool financing under the Florida Industrial Development Financing Act.

Section 9. Amends s. 210.075(1)(a), F.S., to allow the investment of surplus funds by county officers, including the tax collector, as provided in s. 218.415, F.S.

Sections 10. and 11. Amends ss. 236.24 and 236.49, F.S. Requires investment policies of school boards to comply with the provisions of s. 218.415, F.S. The list of authorized investments for school board surplus funds set forth in s. 236.24(2)(a), F.S. (1998 Supp.), is repealed.

Section 12. Amends ss. 237.211, F.S., to provide that the provisions of strict accountability of all funds and an annual audit by an independent certified public accountant as provided in s. 230.23(1)(k), F.S., apply to the subsection instead of ss. 230.23(1)(l), F.S.

Section 13. Repeals ss. 125.31, 166.261, 218.345, 230(10(k), and 237.161(5), F.S., are repealed. These sections of law set individual investment policies for specific units of local government including:

- The investment by a school board of accumulated cash assets not required for a current budget year.
- The investment of county surplus funds.
- The investment of municipal surplus funds; and
- The investment of special district surplus funds.

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

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Local governments not already disciplined in their fund management through the use of a written investment policy will incur expenses in order to bring themselves into compliance with the act. The scope and effect of this compliance can be assumed within existing operating expenses for some; for those with an affected pension plan, the triennial review cycle may permit this compliance by a time certain, but within three years. Costs cannot be estimated with precision. See also Section V.C., *below*.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

The bill affects the investment conduct of units of local governments including counties, municipalities, special districts and school boards. To the extent investment policies improve cash flow management and the quality of the investment decisions, local governments may experience higher rates of return on investment.

However, those units of local government adopting a written investment policy will incur auditing and continuing education expenses in complying with the requirements of s. 218.415, F.S.

VI. Technical Deficiencies:

Upon recommendation of the Joint Legislative Auditing Committee, the Departments of Revenue and Banking and Finance may withhold funds payable to a noncompliant unit of local government. The bill does not give specific powers to the Department of Banking and Finance (Comptroller) to do anything other than receive the recommendation. The specific legal authority for that department to act is not provided in the bill.

The bill provides for the competitive procurement of investments, “except as otherwise provided by law.” It is not clear whether this refers to other general law or to the specific provisions which may be contained in special legislative acts or local ordinances which establish municipal police and firefighter pension plans.

VII. Related Issues:

Many local governmental entities invest a portion or all pension fund assets in the Local Government Surplus Funds Trust Fund. The Trust Fund is a highly liquid investment vehicle with shortened investment maturities yielding conservatively lower rates of return (3-5 percent). Pension funds deposited in the trust will not likely meet the actuarially assumed investment return rate used as the underlying basis to fund local government pension plans. For example, a pension plan whose actuarial assumption uses an 8 percent rate of return on investment may fall short of its investment objective by three to five percentage points using the trust fund as an investment vehicle. Although the investment choice may seem prudent, liquid, and safe, it illustrates the inappropriate matching of investment maturity selection with return on investment objectives. As a consequence to this action, the actuarially determined contribution rates may not be sufficient to fund the plan and an unfunded actuarial liability could occur.

This bill represents an amendment to the first statutory policy statement made on this subject by the Legislature in 1995 following widespread financial adversity in market experiences with derivative investments. Three principal units of government were affected in Florida: Escambia County, Palm Beach County Sheriff’s Office, and the Sarasota/Manatee County Airport Authority.

VIII. Amendments:

None.