

## CITY OF PLANTATION POLICE OFFICERS' RETIREMENT FUND

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To: All Members and beneficiaries of the City of Plantation Police Officers' Retirement Fund

From: Board of Trustees

Re: Explanatory memorandum regarding new disclosure ("Section 112.664 Report")

Date: June 27, 2017

### Overview

This memorandum is intended to provide background and additional disclosure to accompany the new reporting required by Senate Bill 534 (codified as Section 112.664, Fla.Stat.) (hereinafter "S.B. 534"). Although S.B. 534 was adopted in May of 2013, the detailed regulations spelling out the specific reporting requirements and procedures were not finalized by the Department of Management Services in Tallahassee until April of 2015. The Board is pleased to provide this memorandum as a service to the active membership, retirees and beneficiaries and in an effort to answer anticipated questions in connection with the Board's new Section 112.664 Report.

### Legal Protections

Article X, Section 14, of the Florida Constitution specifically protects pension benefits for public employees and mandates that Florida governmental pension benefits are required to be funded "on a sound actuarial basis." Indeed, in Section 5 of S.B. 534 the Legislature declared that it is an important state interest that government retirement systems in Florida be "managed, administered, and funded in a sound manner as required by s. 14, Article X of the State Constitution and part VII of chapter 112, Florida Statutes."

According to state statute, the total contributions to a retirement system "*shall* be sufficient to meet the normal cost of the retirement system or plan and to amortize the unfunded liability" *See §112.64(2), Fla.Stat.* All Florida cities are required to make the mandatory employer contributions to the pension plan "at least quarterly." *See §112.64(1), Fla.Stat.*

The required contributions are actuarially determined by the independent actuary employed by the Board of Trustees. If a city fails to comply with its mandatory pension contributions, the Department of Management Services in Tallahassee is empowered to withhold state funds and tax revenue. *See §112.63(4)(b), Fla.Stat.* Thus, unlike widely reported examples of pension underfunding in other states, Florida law mandates "funding discipline" by the plan sponsor.

## **Funding Discipline**

*As a result of the legal protections for governmental pensions in Florida, by law the Retirement Plan will never become insolvent because it is required to be actuarially funded.* The Retirement Plan is actuarially funded through a combination of investment earnings, city, member and state contributions.<sup>1</sup>

## **Discount Rate/Investment Earnings Assumption**

In order to properly fund the retirement system, the Board's actuary uses several assumptions and federally approved actuarial methods. One of the most important assumptions is the "discount rate", which is otherwise referred to as the Plan's "investment earnings assumption". Even though the discount rate is a long term projection, the Board reviews the investment assumption annually and works closely with independent plan fiduciaries to make sure that plan assets are invested consistent with a long term investment policy. Although investments fluctuate from year to year, the Board has purposely chosen a discount rate which is supported by long term investment performance and financial projections.

## **Unrealized Gains**

Financial markets have performed well for the past several years, following the market correction in 2009. For example, the annualized rate of return by the Standard & Poor's 500 ("S&P 500") index has been approximately 13% per year for the past several years.<sup>2</sup> As a result of the strong equity returns for the past several years, most governmental pension plans have yet to recognize all of the resulting actuarial gains. Accordingly, it is noteworthy "unrealized" investment gains have not yet been recognized in the Board's Section 112.664 Report or the Board's FY 2014 valuation.

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<sup>1</sup> State contributions are available for police and fire pensions under Chapter 175 and 185, Florida Statutes.

<sup>2</sup> Large U.S. equities are a substantial component of the Retirement Plan's investment portfolio, as described under the Portfolio Diversification heading below possible investment return scenarios. For this very reason, new Governmental Accounting Standards Board ("GASB") requirements were recently implemented across the country. In fact, the Board's FY 2014 valuation contains a projection of benefit payments for the next 100 years. A copy of the Board's FY 2014 valuation containing the new GASB 67 100 year projection is available upon request, as are the additional sensitivity testing calculations performed by the Board's actuary.

## **Sensitivity Testing**

S.B. 534 requires the Board to provide *hypothetical* "run out" dates, assuming that the Board used a theoretical investment return assumption of 2.00% less than the Board's current discount rate. All things being equal, the use of a lower investment return assumption will lower the Plan's current funded ratio. S.B. 534 also requires the Board to include in the new Section 112.664 Report additional "run out" dates, assuming that the plan sponsor, member and State of Florida, stopped contributing to the Retirement Plan. As described above, Florida law mandates funding discipline by plan sponsors. Accordingly, the hypothetical run out dates in the S.B. 534 report are an academic exercise which do not impair the ability of the Board to pay constitutionally protected benefits.

In addition to the "run out" dates required by S.B. 534 in the new Section 112.664 Report, the Board also directed its actuary to project the Retirement Plan's valuation using an investment return assumption of 2.00% higher than the Board's current discount rate. In other words, the Board is of the view that proper "sensitivity testing" requires the evaluation of several.

## **Amortization schedule**

Defined benefit pensions are paid monthly over a retiree's or beneficiary's lifetime. As a result, pension trustees invest with a long term investment horizon. By law, Florida governmental plans are permitted to amortize their liabilities over thirty years. While the "funded ratio" of many Florida governmental plans is less than 100%, it is anticipated if all assumptions are borne out that the Retirement Plan will be approximately 100% funded at the end of the 30 year amortization period. Many professionals consider the Board's amortization schedule to be similar to a 30 year mortgage. The remaining balance on one's mortgage is usually less important than the ability to make the full monthly payments.

## **Portfolio diversification**

As long term investors the Board employs a long term investment strategy which is based on a written investment policy. The Board retains a qualified investment consultant who monitors the Board's portfolio, as a fiduciary, consistent with the Board's investment policy. The Board's investments are diversified into several assets classes managed by different investment advisors in order to minimize volatility in the portfolio. The past five years of investment returns (along with the allocations of cash, equity, bond and alternative investments) are set forth in the new Section 112.664 Report. A copy of the Board's quarterly investment reports are available upon request.