History of Public Pensions

By: Raymond T. Edmondson, CPPT

A Founder and CEO of the Florida Public Pension Trustees Association

Raymond T. Edmondson is the Chief Executive Officer of Florida Public Pension Trustees Association. Mr. Edmondson served in the US Navy Seabees. Mr. Edmondson was a member of the Fraternal Order of Police Ft. Lauderdale, Florida, Lodge 31. He has served as President for 7 years, State FOP Lobbyist, Legislative Chairperson, Local Legal Assistance Chairperson, Administrator of Health Insurance Program, Trustee Police & Fire Pension System for eight years, and is founder of FPPTA and SPPON. Raymond graduated from Don Bosco Tech Catholic Boys School, he received the Machine Design Award for Machine Technology. Farleigh Dickinson University Industrial Engineering, New Jersey. Raymond is a Certified Public Pension Trustee in Florida. Raymond attended Broward Community College, Florida and Florida Atlantic University, Florida receiving a degree in Criminal Justice.

The first Public Pensions were issued for the Revolutionary War, 1775 to 1783. These were monthly payments only.

During the presidency of Republican Theodore Roosevelt, the 26th President of the U.S.A., 1901 to 1909, Roosevelt started the "Square Deal" which consisted of universal education, Civil Rights, and Universal Health Care. He also enacted pensions for Civil War veterans, war of 1861 to 1865, which consisted of monthly pay checks, disability payment and survivorship rights. This created an unexpected reaction when 14 and 15 year old girls married 70 year old men.

In 1920, the Federal Government created Civil Service which covered all government employees and covered them for retirement pensions, disability and health care. The concept of retirement pensions slowly filtered down to the municipal level.

The concept of a defined benefit retirement payment has become a vital part of national and local economies.

Along with the development of pensions came workers rights during Theodore Roosevelt's presidency. He personally mediated the first employee owner dispute or should I say, war, machine guns, hand guns, long guns, killing each other. The war was between the coal miners of West Virginia and Tennessee and Andrew Carnegie who needed coal for his railroads and steel mills. The working conditions in the mines were sub-human. President Roosevelt found in favor of the employees, hence the United Mine Workers was founded.

The miners tied red bandanas around their necks for identification purposes – hence the term "red necks" emerged.

BULLET POINTS

1. The History of Public Pensions
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If you live long enough you will fight the same battles at least twice.

The History of Public Pensions in Florida

In the mid to late 60's, most public employees had insurance annuities. The fees were overwhelming. The city fathers picked insurance carriers and brokers. This proved to be a very corrupt situation. When these scandals were uncovered, they fled town on their yachts. Some went to jail.

DEFINED BENEFIT PLANS

The individual policies were replaced with Defined Benefit pension systems. These systems were run again by city management. When the employees found out that management was spending the pension funds on palm trees and manhole covers. State legislation was introduced to set up trust funds with minimum standards. The standards were opposed by city management, the League of Cities and pension administrators. After three years of failing to pass the legislation it was signed into law in 1983.

This legislation that was backed by the police and fire organizations plus pension trustee revolutionized the Florida Public Pension systems and set high standards for the rest of the country.

OTHER LEGISLATION

From time to time the employee organizations, along with pension trustees, have fought the same people to update the standards.

June 1, 2009 Senate Bill 538 was signed into law after an 18 year battle. For the past eight years the changes in 175 and 185 were spearheaded by the Florida Professional Firefighters (FPF) and the Florida Public Pension Trustees Association (FPPTA). This legislation covered the following:

1. Creatable service definitions for 175 & 185

2. Terms of trustees on local 175 & 185 pension boards making them optional for two to four years.
3. International equity percentage raised from 10% to 25% for 175 & 185 trust funds
4. Termination of pension systems relating to payments to participants plus retirees. The section is consistent with the City of Lake Park case, where they were told that if they terminated their DB plan the unfunded liability would go away. Attorney Matthew Mierzwa of Mierzwa and Associates represented the employees against the League of Cities. The local court found in favor of the League of Cities and Lake Park. We were not surprised. On appeal, the court found in favor of the employees and trustees. I was told by a League attorney that the League did not recognize the Court of Appeal's decision and it would have to go to the Florida Supreme Court first. Now it is law.

HOW DO YOU CREATE A PENSION SYSTEM

The State of Florida has three processes to create a public pension system.

1. Local Law Plans:
   The Pension System is established by an ordinance of the plan sponsor. (Local Government)
2. Chapter Plans:
   The local government adopts the minimum standards of State Statutes, Chapters 112 – 175 – 185,
   SS112, governs all public pension systems.
   SS175 governs fire plans
   SS185 governs police plans
   Both 175 and 185 plans also have to comply with 112 and other State Statutes.
3. Special Act Plans:
   This is an act voted on and created by the State Legislature, which mandates a local government to create a public pension system with provisions stated in the act.

TYPES OF RETIREMENT PLANS

The most recognized and proven plan is a <u>Defined Benefit</u> Pension System. In a Defined Benefit system, the benefit is guaranteed and defined. Employees and employers contribute to the plan and the monies are invested. Both employers and employees have representation. The plans are overseen by elected trustees.

The Retirement Benefit is determined by years of service, final earnings time a multiplier. Hence the longer you work for an employer, the higher your salary, the higher your retirement benefit.

<u>Defined Contribution Plans</u>

These type plans are in most quarters looked at as Employee Investment Savings Plans. You hear about 401K – 457 and insurance annuities. The only thing guaranteed or defined is your contribution. There is no guaranteed retirement income. An insurance annuity does provide a guaranteed retirement income. The fees on these Defined Contribution Plans are quite excessive. When someone tells me they would rather have a Defined Contribution Plan rather than a Defined Benefit Plan, the first question I ask is "How long are you going to live?"

Can you run out of retirement income?

Defined Benefit Plan: NO

Defined Contribution Plan: YES

HOW DO YOU DISCONTINUE A PLAN?

Defined Contribution Plans – Stop contributions

Defined Benefit Plans

1. Close the plan to new members. You are required to fund the plan until the last beneficiary dies.
2. Terminate the plan. You must pay all participants their accrued benefits and continue to pay beneficiaries until death.

Both ways are very expensive. Some Cities (Plan Sponsors) close a plan and start a new plan with lesser benefits. Or keep their plan and make tiered benefits. Also a bad idea when new employees talk to current employees. Two people doing the same job with different benefits.

Then there is always the Florida Retirement System (FRS). There is no local control. The pension system is run by three politicians, to which you have no voice. FRS for the most part has lesser benefits, no employee contributions, just taxpayers' money and investment returns. The only thing the Cities get is a bill that they can't dispute or else the State will cut off all their funds. No part payments allowed. FRS final compensation, that calculates your retirement, is based on the average of your past five years' salary. Some Municipal Plans are based on the highest year out of your last five years. The calculation based on the highest year is greater than the average. FRS disability is based on an employee's ability to perform any function, not just that of a police officer or firefighter. Municipal disabilities are based on work class for police and firemen. This means that in a municipal plan, if a police officer or firefighter can no longer perform their duties, they are disabled. FRS is based on the ability to perform as an employee. If a police officer or firefighter can no longer perform their duties, they can be assigned other duties, such as cutting grass. This will impact your final compensation. FRS also may change benefits without input. They have in the past reduced benefits. Currently in 2009, the State has attempted to reduce employees' salaries, which reduces final compensation. Once the change is made to go under FRS, there are no changes. Once you are in, you can't get out.

Who invests the funds in FRS? The State Board of Administration (SBA) invests all State funds. Who regulates the SBA? An administrator who works for the same three politicians who are the FRS trustees: the Governor, the Attorney General and the Chief Financial Officer of the State. When the city and county investment fund showed a financial failure and the funds were frozen, the Governor attempted to transfer funds from FRS. The other two trustees voted against it. The Governor only needed one vote to do whatever he wanted. It's all state taxpayers' money plus investment returns. Participants have no voice.

The Health Care Benefit Fund will give out more funds than it collects in 2010. For years the State has taken funds from the SBA, mostly cash, to pay its debts. Research has for years produced the same results that locally controlled Defined Benefit plans, with representation from the plan sponsor (local government) and employees, with employee and local governments' contributions, is the best way to go. Traditionally, Defined Benefit Pension Plans are an important reason why many employees choose public sector careers rather than higher paying private jobs.

The impact of those plans is far reaching in our economic growth. Public Pension Defined Benefit Plans show prudent investments in rebalancing their investment policies to avoid high risk.

Defined Benefit Plans have a clear cost advantage over Defined Contribution Plans. Some research shows that Defined Contribution Plans cost upwards of 46% to 47%, and more, than Defined Benefit Plans.

1.	Longevity Risk Producing Savings	15%
2.	Portfolio Diversification Savings	5%
3.	Superior Investment Returns Savings	26%
	Total Savings	46%

The above figures do not calculate the financial loss created by DC plans, in that employees operate as independent contractors and move from city to city for higher pay and benefits and promotions. This leaves the cities with the expense of retraining and attempting to retain loyal and qualified employees. Again, this has proven to be very costly for all employers.

Legislation has been proposed in several states to replace state and local government Defined Benefit (DB) retirement plans with Defined Contribution (DC) retirement plans, also commonly called 401(k) plans. Moreover, a number of states have further proposed that state government should assume management of all municipal pension funds, including DB plans, arguing that state managed funds would be less expensive to administer and would yield higher returns.

The Florida Public Pension Trustees Association (FPPTA) is confronting numerous myths and misinformation about such changes in Florida, and how they might impact municipalities, public employees and local economies.

State officials have presented what appears to be a convincing case for these proposed changes and have utilized the media to broadly disseminate the message that DB plans are too expensive, too generous and too loosely constructed. In fact, there is compelling evidence to the contrary, and Florida taxpayers should be fully informed of the facts.

At issue is not whether state and local employees should have access to DC plans – many already do in conjunction with their DB plans or through supplemental DC-type savings.

In fact, the FPPTA supports retirement planning that encourages employees to participate in multi-pronged savings strategies that will support them throughout the duration of their retirement, and that includes DC plans. But the allure of Defined Contribution plans as a replacement and therefore a panacea for government savings is a myth. When examined closely there are at least 10 reasons why DB plans offer the best value for the state, its employees and taxpayers.

1. Claims that DB plans are too expensive to support right now in the face of fiscal crisis are false. In fact, a DB plan is likely to cost state and local government less over the short term, and long-term costs savings of switching to a DC plan are uncertain at best.
2. DB plans provide disability and survivor benefits in addition to retirement income. Switching to a DC plan would require state and local governments to provide these benefits via some other revenue source – and they are key benefits for large numbers of employees like firefighters and police officers who depend on them.
3. DB plans enhance the ability of state and local governments to attract qualified employees and to retain them throughout their careers. The cost of re-training state and municipal employees is significant, and the fact is that employees with DC plans who change jobs and careers often wind up tapping into their DC plans, or find they cannot transfer them, lessening their ability to accrue benefits they will need long term.
4. Locally administered DB plans provide flexible incentives that encourage employees to work longer or retire earlier, depending on the circumstances of the individual government agency or municipality. A state controlled and administered fund would eliminate this important control affecting employers.
5. DC plans require individuals to fund their own retirement, while DB plans pool risk over larger numbers of participants, lowering the overall risk of investment losses and enabling funds to be more aggressively invested for longer term earnings.
6. DB plans earn higher investment returns and pay lower investment management fees, on average, than DC plans. This makes DB plans more cost effective for employers and therefore, the taxpayers.

7. DB plan investment earnings reduce future employer contributions. Suggestions that taxpayers cannot afford DB plans are myth. In fact, most of the money paid into state and local retirement plans comes from investments – investments that continue to earn at the highest possible rates because of risk pooling. ***Investment earnings currently fund over two-thirds of public retirement benefits.***
8. Approximately 25 percent of state and municipal employees are not covered by Social Security, including close to half of public school teachers and about 70 percent of police officers and firefighters. DB plans provide secure retirement benefits based on a person's salary and period of service. Without DB plans, these employees would be a great risk, and local and state government would be pressured to provide a substitute for the revenue loss.
9. Studies abound that show DB plans have a substantial impact on state and local economies. State and local retirement plans act as financial engines, using employer and employee contributions to generate investment income that, when paid as retirement benefits, bolsters state and local economies by $200 billion a year.
10. DB plans provide reliable benefits throughout retirement, while DC plans often will earn less than what is needed to ensure an adequate standard of living. State and local governments will experience the pressure to augment DC plan benefits that will cost taxpayers more money.

There are a multitude of national studies providing compelling evidence that Defined Benefit Plans are the most cost effective solution for providing predictable, reliable earnings for retirees whose careers in government service or municipal professions are rewarded with the promise of financial stability throughout retirement.

Employees and retirees who have financial stability spend money. The local and national governments gain.

MYTHS

1. TAX PAYERS MONEY

What does that mean? What isn't taxpayer's money?

Municipal Defined Benefit Plans are autonomous trust funds protected by law. It's not employee money, taxpayer money, city money. It is trust fund money. On a general average, they consist of:

Employee Contributions of 6% to 10%

Investment Earnings of 74% to 76%

Employer Contributions of 14% to 16%

Remember the employees also pay taxes. These figures also cover disability, death and survivorship benefits. Not a bad deal.

2. UNDERFUNDED PLANS

This usually relates to the Unfunded Liability. A liability that most of us carry in our private lives, called your mortgage, car payment, etc.

Defined Benefit Plans are calculated on actuarial assumptions such as contributions, benefit levels, years of employment, mortality tables, retirement ages, etc. You can see why most actuaries are not stand up comics. The liability is also based on a 30 to 35 year time frame with a prediction (assumption) of earnings, usually 8%. How they do that is beyond me. So when some people state a plan is under funded, they mean it is not 100% funded. 100% funding means, if everyone covered by the plan requested payment of benefits or refund of contributions, the fund could not pay all. Is this a big deal as some newspaper reporter's state? Not really unless the plan is grossly under funded. In Florida, most plans are 85% to 100% funded. [1]

[1] When a fund is underfunded by 10% that means the fund is prefunded 90%. When funds are grossly underfunded by 50% to 60% they need to revisit their investment strategy and actuarial assumption. I know of no plans in Florida who are in this position.

3. WHY ARE SOME PLANS UNDERFUNDED?
    a. New start-up plans.
    b. Cities took holidays from funding.
    c. Increase in benefits without increase in funding.
    d. Poor investment returns

I imagine someone will come up with another reason, but if you solve these reasons, you will be in good shape.

Bigger plans are better and safer than smaller plans. I don't put too much logic in that statement. If your plan is actuarially sound, and investment policies are diversified, what's the difference? You will get the same percent of earnings as everyone else.

4. TRUSTEES INVEST ASSETS.

The assets of a Municipal Pension Trust Defined Benefit Plan are invested by professional money managers. They are overseen by professional consultants. These funds have independent attorneys, accountants and auditors. The trustees are the best educated in the country. All professional and trustees who oversee the fund are by State law fiduciaries and are held to high ethic standards.

5. WHAT IS AN "ADEQUATE RETIREMENT BENEFIT"?

One that lends to the quality of life you had when you were working.

6. HOW DOES ONE ACHIEVE RETIREMENT STABILITY?
    a. Your basis should be a Defined Benefit Retirement Plan
    b. Diversification of individual investments
    c. A Defined Contribution Plan
    d. Personal savings
    e. Social Security
    f. Insurances, such as death, long-term care, medical

Most people put more time in planning a vacation than they do retirement.

7. HOW DID WE GET INTO THIS SITUATION?

   With the attempt to make government smaller and to shift the responsibility of retirement onto the shoulders of employees coupled with the search for cheap labor, the Defined Contribution Plans surfaced again. Then, after private industries, the public sector attempted to follow suit. This was shown to be a disaster. State after state attempted to take over all local pension systems and then convert them to Defined Contributions Plans. The employees and unions became the whipping boys. The politicians who created the problem with excessive spending stand by harmless.

Resources:

Institute on Retirement Security

NCPERS Research Series

Florida Public Pension Trustees Association

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