

Police Officers' and Firefighters' Pension Reform Commission

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Police Officers' and Firefighters' Pension Reform Commission Report to Legislative Council

Committee Charge

The Fire and Police Pension Association (FPPA) was established in 1980 and administers two funds: the Fire and Police Members' Benefit Investment Fund and the Fire and Police Members' Self-Directed Investment Fund. Assets in these funds are used for a number of pension plans including the Defined Benefit System, the Statewide Death and Disability Plan, and numerous separate "Old Hire" plans for police officers and firefighters throughout the state of Colorado. Pursuant to Section 31-31-1001, C.R.S., the Police Officers' and Firefighters' Pension Reform Commission has the responsibility to study and develop proposed legislation relating to funding of police officers' and firefighters' pensions in this state and the benefit designs of such pension plans. The statute directs the commission to study, review, and propose legislation related to these issues including, but not limited to, the following subjects:

- normal retirement age and compulsory retirement;
- payment of benefits prior to normal retirement age;
- service requirements for eligibility;
- rate of accrual of benefits;
- disability benefits;
- survivors' benefits;
- vesting of benefits;
- employee contributions;
- post-retirement increases;
- creation of an administrative board;
- creation of a consolidated statewide system;
- distribution of state funds;
- coordination of benefits with other programs; and
- the volunteer firefighter pension system.

Commission Activities

The commission held one meeting during the 2012 interim. At this meeting, the FPPA informed the commission on the state's involvement in fire and police pension plans and recent activities of the FPPA Board of Directors. The FPPA and the commission also engaged in a discussion regarding the administrative efficiency of the pension plans. In addition, the FPPA discussed the recent investment performance of pension funds and recommendations by the board to improve the funding status of FPPA plans. The commission also took up a brief discussion of the state's payment schedule for old hire plans.

Recent investment performance. The FPPA informed the commission that net investment assets totaled \$3.378 billion at the close of 2011. These assets are held in the Fire and Police Members' Benefit Investment Fund (\$3.079 billion) and the Fire and Police Members' Self-Directed Investment Fund (\$0.299 billion). For this period, the gross rate of return on the Fire and Police Members' Benefit Investment Fund was 1.23 percent (0.73 percent, net of fees), compared with a 14.26 percent (13.68 percent, net of fees) return in the prior year. Asset allocation was

largely made up of global equity investments (46.9 percent) and fixed income investments (18.8 percent). The FPPA noted that asset allocation is a significant factor when evaluating investment performance. As one example of change in response to the current economic environment, the FPPA reduced real asset investments such as real estate from 7.0 percent of holdings in 2009 to the 4.0 percent range in 2011 to reduce investment risk.

In terms of 2012 investment performance, the FPPA gave the commission an update on fund performance for the first two quarters. Earnings for the bulk of FPPA investments were in excess of the 10 percent range for this period. The FPPA noted that the investment strategy for global equity investments, which represented nearly 50 percent of the portfolio, is largely a hedge against downside market risk. The Fire and Police Members' Benefit Investment Fund had a net return of 5.7 percent year-to-date through July 2012.

Actuarial study findings. At least every five years, the FPPA Board of Directors reviews its economic and demographic actuarial assumptions. The FPPA informed the commission that the approved recommended changes made by FPPA actuaries, Gabriel, Roeder, Smith and Company, were based on recent investment experience and future expectations. These changes projected a more conservative position for future costs. Changes included:

- a lowering in the normal investment return from 8.0 percent to 7.5 percent, considering a reduced inflation assumption given the current bond market;
- a reduction in the pension model inflation assumption from 3.5 percent to 3.0 percent; and
- a revision in the post-retirement mortality tables to reflect longer life spans.

Funding status changes. The FPPA informed the commission that the ratio of assets to liabilities, commonly referred to as the funded ratio, for the Statewide Defined Benefit Plan decreased from 102.9 percent as of January 1, 2011, to 96.4 percent as of January 1, 2012. The decrease in the ratio was attributed to changes triggered by the actuarial study findings and investment returns that were below the assumed 7.5 percent rate of return during 2011. During the same time period, the Statewide Death and Disability Plan funded ratio increased from 108.0 percent to 113.7 percent at the beginning of 2012. The increase in the ratio was largely due to a change in the level of claims. Also, the state-assisted old hire plan unfunded liability increased by \$113.7 million between 2011 and 2012 mainly due to increased liabilities.

Payments to the FPPA old-hire pension plan. The commission was given a brief history of the state's requirement to make payments to the FPPA old-hire pension plans. Until 1978, all fire and police pension plans in Colorado were administered and funded by local governments. Although the state provided some assistance, there was no statutory requirement that these plans be funded on an actuarially sound basis. By the mid-1970s, it became apparent that many of these local plans were underfunded.

A 1977 study by the General Assembly concluded that these plans had an unfunded liability in excess of a \$500 million. In 1978 and 1979, the General Assembly adopted legislation to reform the pension system. The purpose of the reform was to ensure that local pension plans were actuarially sound and included state financial assistance conditioned on increases in both employer and employee contributions. The state currently provides assistance to eight old-hire plans under the management of the FPPA. Since 1980, the state has contributed more than \$500 million to 110 local police and fire agencies.

FPPA limitation on liability. The chief executive officer and legal counsel of the FPPA discussed issues relating to local governments with employees that claim benefits but have not paid FPPA premiums because the local government did not have their members enrolled in FPPA plans. Individual police officers and firefighters may believe they are entitled to benefits due to state statutes that require local government police and fire agencies to provide benefits through FPPA. However, a number of these local agencies elect not to enroll their employees in FPPA, and, in some cases, FPPA statutes become applicable to a local agency without the local agency being specifically aware of this occurrence (e.g., following a transition from all-volunteer to career firefighting personnel). The commission discussed the issue of liability for benefit claims from police officers or firefighters when their employer has not enrolled potential members in FPPA plans. FPPA executives noted that, while FPPA is not currently liable for such claims, enforcement action against local agencies that violate enrollment statutes is not a contemplated use of FPPA trust funds and no resources currently exist to take enforcement action.

As a result of this discussion, the commission recommends Bill A. Bill A clarifies that FPPA has no obligation related to fire and police employers that fail to enroll employees in FPPA plans.

Commission Recommendations

As a result of commission deliberations, the commission recommends one bill for consideration during the 2013 legislative session.

Bill A — FPPA Limitation On Liability. Bill A amends existing statutes related to FPPA's statewide defined benefit (pension) plan and the statewide death and disability plan. The bill provides that FPPA is not liable for or obligated to pay any benefit when a local government fails to enroll its employees as members of FPPA.