

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 590

SPONSOR: Committee on Governmental Oversight and Productivity

SUBJECT: Florida Retirement System

DATE: March 11, 2002 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	Favorable/CS
2.	_____	_____	AGG	_____
3.	_____	_____	AP	_____
4.	_____	_____	RC	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill establishes employer-paid payroll contribution rates for the Florida Retirement System for the fiscal year ending June 30, 2003 and recognizes a portion of the pension surplus. The bill permits certain members to upgrade service, recognizes a portion of the pension surplus, provides increased funding for educational outreach for the FRS investment plan, and makes a declaration of an important state interest.

II. Present Situation:

The Florida Retirement System (FRS) is a defined benefit (DB), non-participatory, multi-employer pension plan covering the employees, survivors, and dependents of some 800 Florida state and local government employers. It offers a monthly benefit payable in the form of an annuity over a retiree's lifetime that is calculated as a percentage of the highest five years' of a member's average final pay. The FRS is composed of several subclasses of membership with separate benefit accrual rates: Regular (1.60 percent-1.68 percent); Special Risk (3.00 percent); Special Risk, Administrative Support (1.6 percent); Senior Management (2.0 percent); Justices and Judges (3.33 percent); and Elected Officers (3.0 percent). Normal, unreduced retirement occurs at the earlier completion of 30 years of service or age 62, or 25 years of service and age 55 for the two special risk classes. Members must satisfy minimum service periods in order to qualify, or vest for benefits. Effective July 2001, the three separate vesting periods of 7, 8, and 10 years were collapsed into one uniform 6-year period. Incorporated within the DB plan is a disability retirement provision that provides in-line-of-duty and non-duty retirement payments.

The FRS is a predominantly local government plan with state officers and employees comprising only about 25 percent of the total membership. The other principal employer categories are

district school boards, counties, and community colleges. Membership is compulsory for state agencies and constitutional entities. Municipalities and independent special districts may participate as optional members upon resolution of their governing authorities. Withdrawal of optional membership can be affected only by statute and was last done in 1995 for public hospitals.

Benefit administration is the responsibility of a statutory agency, the Division of Retirement in the Department of Management Services. Investment activities are conducted by a constitutional agency, the State Board of Administration, headed by the Governor, Comptroller, and Treasurer in their collegial capacity as Trustees of the Florida Retirement System. Article X, s. 14, State Constitution, provides that all public pension plans in the State of Florida must fund promised benefits in advance in a sound actuarial manner.

The FRS was created in 1970 as the successor benefit plan to the separate Teachers' Retirement System, Highway Patrol Retirement Plan, and State and County Officers' and Employees Retirement System. The predecessor teachers' plan was approaching insolvency and its combination with the other solvent plans rescued it from collapse. In 1972 the FRS incorporated the last independent state retirement plan, the Judicial Retirement System. Today it covers about 600,000 active employees and nearly 200,000 retirees. Active members may choose to participate in a Deferred Retirement Option Program (DROP) during the last five years of their service. Under its provisions participants have their monthly pension benefit paid into an interest bearing account. Upon termination of employment they receive the additional options of a full or partial lump sum payment of that amount plus its accrued 6.5 percent interest or they may transfer the account balance plus accrued interest into a qualified retirement plan.

Retired members receive a 3 percent fixed cost-of-living allowance each July 1 on their monthly benefit. Members who have terminated employment with vested rights, that is, the right to receive a benefit, do not have these benefits indexed to inflation until commencement of pension payments. State of Florida employees have the option of maintaining their health insurance coverage at retirement at full cost less a monthly Health Insurance Subsidy payment equal to \$5 per month per year of service, not to exceed \$150.

Between 1984 and 1999 the Legislature created three other alternative pension arrangements to the FRS for covered employees. Administrators and faculty in the State University System and the Community College System and executives in the Senior Management Service may enroll in a defined contribution plan. About 12,000 employees among all three employer types have selected this choice. A defined contribution (DC) plan offers the participant the choice of pension portability from employer to employer, immediate or 1-year vesting instead of 6-year vesting, and personal ownership of, as well as personal responsibility for the investment choices. These plans are "front-loaded," that is, they provide immediate ownership of pension dollars without any forfeiture should the participant terminate employment prior to vesting. Employer contributions are pre-tax and are roughly equivalent to the normal costs of the DB portion of the FRS. Employees may make post-tax contributions to their DC accounts subject to federal earned income limitations. DC plans operate in marked contrast to "back-loaded" DB plans which are structured to encourage career commitment and value the last five years as the most valuable. A DC plan assures only an employer payroll contribution, not a benefit result. The time-honored euphemisms of "thirty and out" and "high five" no longer apply: net asset value at the close of

markets, Eastern Time is all there is. The Florida DC plans, unlike many of their corporate 401(k)-type counterparts, are also structured as annuities and do not offer lump-sum features. Counties and school boards have the additional statutory authority to offer early retirement annuities to their departing members to compensate them for any penalties they may incur for non-normalized benefits.

In 1999 the Florida Senate passed Senate Bill 356. It was designed to create a DC and DB pension choice for most members of the FRS. Participants would be able to enroll in the plan of their choice and receive an equivalent payroll contribution, then set at 9.21 percent of salary, by their employer. The choice would be unconstrained and would be accompanied by employee education and information on the elements and consequences of choice. The bill was patterned after the existing optional retirement plan choices for educators and managers and the state's deferred compensation program. Employees would enroll with one or more of the several qualified investment and insurance providers that would offer whatever array of services, or the "bundle," the participant believed valuable to purchase. The bill did not pass the House of Representatives but did precede the discussions undertaken during the 2000 Regular Legislative Session that resulted in passage of ch. 2000-169 (HB 2393/SB 1026), Laws of Florida.

Senate Committee Interim Report 2001-021, "Implementation of Pension Choice for Florida Public Employees" discussed in greater detail how public employee benefit programs are beginning to emulate the large-scale economic transformation from a job-based to a knowledge-based environment. The report traced the evolution of the Special Category appropriation and the increasingly greater role played by government contractors and their supplanting of direct service delivery by public employees. That shift from direct to indirect service delivery was accompanied implicitly by a shift from DB to DC pension management as contractors do not envision creating streams of unfunded employer liabilities in a competitive market where business infrequently exists for a lifetime.

Chapter 2000-169, L.O.F., created a Public Employees Optional Retirement Program and provided all employee participants of the FRS the opportunity to enroll initially in a DC plan or to transfer with a discounted account balance from the DB. Each category of public employer – state, county, school board, and optional member – would be afforded a 90-day election window in which their employees could select the optional plan. Like SB 356 the choice was unconstrained – the failure to choose would maintain DB membership - and was to be accompanied by a broadly based information and education curriculum. Unlike that previous legislation, however, the plan would permit employees to transfer back to the DB plan once after their DC enrollment. It also would be organized on a wholesale, or "unbundled" basis in which the SBA would select the fund providers and slot them into predetermined asset classes. In this arrangement provider companies would compete on the basis of cost and performance of their individual investment offerings. They would not provide ancillary services to the participant such as estate planning, related investment products, or plan servicing as those elements became either non-existent or made the responsibility of an SBA retained third-party administrator. The disaggregation of services was a central feature of ch. 2000-169 as it contemplated overlaying the investment infrastructure of the SBA over the procured best-of-class funds to produce superior returns at minimal participant cost. The SBA believed itself to be in a commanding presence to produce this result, not only as a consequence of the stated objective of the law, but also by virtue of the procurement fitting into its own organizational deployment: it purchases on

a wholesale basis as an institutional investor for the DB plan. Neither it nor the Division of Retirement engages in any ancillary activities outside the narrow scope of investment management and benefit administration thus keeping expenses low enough that the division reports itself as the national public pension plan leader in organizational efficiency as measured by cost per member.

The SBA has proceeded since the passage of ch. 2000-169, L.O.F., with the assembly of the implementing apparatus. In coordination with its own Investment Advisory Council and the separately created Public Employees Optional Retirement Plan Advisory Committee it created four distinct work groups: an Investment Services Implementation Group (for the selection of investment product providers); a Third Party Administrator Implementation Group for the qualification and selection of a centralized financial services intermediary (CitiStreet); an Education Services Provider Implementation Group for initial and transfer education (Ernst and Young/Financial Engines/Watson Wyatt); and an Asset Transition Work Group for the brokerage transactions incidental to the transfer of account balances from DB to DC. In the course of its public hearings, the SBA has published an Investment Policy Statement (IPS) in which it outlined the plan design and procurement objectives. The IPS has been promulgated additionally as a rule under the state's Administrative Procedures Act, ch. 120, F.S.

Effective March 1, 2002 the initial information and education period began for state employees with the first choice period for DB to DC enrollment to begin June 1, 2002. In succeeding calendar quarters district school boards and local governments will begin their choice periods with the open enrollment ending in early 2003 for existing employees.

Interim Report 2002-134 discussed the significant and adverse funding issues which have beset the indemnity health insurance program provided officers and employees of State of Florida agencies. The report suggested several types of changes that could be made ranging from upward adjustment of employee payment responsibility to more systemic changes affecting the scope of coverage. The 2001 Legislature commissioned the completion of a consultant report on specific financial and programmatic changes to this indemnity plan and directed its delivery by December 31, 2001. That report should provide a more precise indicator on the types of changes required, and their necessary time frames, to bring the plan greater financial stability.

For the previous two years the Legislature has utilized a portion of the surplus in the plan to subsidize the ordinary, or normal cost, of the plan. In so doing it has used the excess assets of the plan, partitioned by the 2001 Legislature into a base and available surplus, to fund other governmental priorities. As long as the funding methodology does not violate the provisions of Part VII of ch. 112 and Art. X, s. 14, State Constitution, the Legislature can allocate these revenues as it sees fit. Each year the plan receives an annual valuation of its assets and liabilities that, in turn, is subjected to a second-opinion review by an actuarial firm under contract to the Legislature.

III. Effect of Proposed Changes:

Sections 1, 2, and 3. Sections 121.052, 121.055, and 121.071, F.S., are amended to provide for the fiscal year ending June 30, 2003 and for the fiscal year beginning July 1, 2003 revised employer payroll contribution rates for the FRS, as follows:

**Employer Payroll Contribution Rates,
FRS, by Fiscal Year Ending 2002, 2003, 2004**

Retirement Class	FY 2002	FY 2003	FY 2004
Legislators, Governor, Cabinet	15.14 %	9.26 %	15.42 %
State Attorneys, Public Defenders	15.14 %	9.26 %	15.42 %
Justices, Judges	20.61 %	15.42 %	20.64 %
County Elected Officers	17.61 %	12.00 %	17.52 %
Senior Management	11.73 %	6.14 %	11.68 %
Regular Class	9.91 %	4.16 %	9.94 %
Special Risk	22.07 %	15.30 %	22.15 %
Special Risk, Administrative Support	12.55 %	6.69 %	12.60 %

Section 121.055, F.S., is further amended to provide that a state attorney or public defender in the Elected Officers' Class may upgrade service as an assistant state attorney or assistant public defender in accordance with the upgrade provisions contained in law.

Section 4. The bill recognizes a reduction of 5.05 percentage points in each class and subclass of the FRS below its normal costs through recognition of a lump sum from the excess actuarial assets for the fiscal year ending June 30, 2003.

Section 5. The bill amends s. 11 of ch. 2001-235, Laws of Florida, to recognize the sum of \$15.1 million to fund the repurchase of the special cost-of-living increase provided active and retired members originally afforded only a 2 percent accrual rate between 1978 and 1991.

Section 6. Section 121.571, F.S., is amended to increase from .10 percent to .15 percent the assessment made on FRS employers to fund the administrative and educational expenses of the FRS alternative investment plan that began initial operation on March 1, 2002.

Section 7. Section 23 of ch. 2000-169, Laws of Florida, relating to increased retirement contribution rates, is repealed.

Section 8. Effective July 1, 2002, and effective for that fiscal year only, each FRS employer shall pay .15 percent of each member's gross compensation into the System Operating Trust Fund to offset expenses associated with information and education. The contributions are exempt from the trust fund service charges imposed under s. 215.20, F.S.

Section 9. The bill provides a declaration of important state interest.

Section 10. The act takes effect July 1, 2002.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

The bill provides a declaration of important state interest.

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 reduces the cost to public employers for each participating employee. The bill does not specifically weight the rates to be charged on the basis of the expected annualized enrollment of 178,000 in the investment plan. There will be an interaction effect of this stratified enrollment requiring an adjustment, or blending of the two rate structures. That blending is not reflected in the rates charged in this bill.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The bill affects contribution rates assessed for participants in the DB plan. Employees electing to enroll in the investment plan will have contributions set at normal cost for their retirement class.

VIII. Amendments:

None.