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/CS/SB 958

SPONSOR: Appropriations Committee and Governmental Oversight and Productivity Committee

SUBJECT: Retirement/District School Board/Florida Retirement System

DATE: April 15, 2003 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Matthews, Jr.	O'Farrell	ED	Fav/1 amendment
2.	Wilson	Wilson	GO	Fav/CS
3.	McVaney	Coburn	AP	Fav/CS
4.				
5.				
6.				

I. Summary:

This bill authorizes a district school board to reemploy certain retired personnel on a contractual or noncontractual basis as instructional personnel or administrative personnel certified as instructional personnel following one month of retirement. The bill further revises the payroll contribution rates for the Florida Retirement System (FRS); reduces the administrative expenses charged for educational programs undertaken by the Board of Administration; prescribes the same distribution options for community college personnel in the optional retirement annuity program as is in effect for university personnel; and permits designated instructional personnel in district school boards to extend their participation in the Deferred Retirement Option Program (DROP) by an additional three years, subject to the approval of the hiring authority.

This bill amends ss. 121.051, 121.091, 121.40, 121.4501, 121.71, 121.74, and 1012.875, Florida Statutes.

II. Present Situation:

School Board Reemployment of Certain Retired Members

A member of the Florida Retirement System (FRS) may retire and be employed by any employer not participating in the FRS without impacting the retiree's benefit. To receive the retirement benefit, the member must be off the payroll of all FRS participating employers for one calendar month. If the member is reemployed by an FRS participating employer during that first month, the member's retirement is voided and the member continues to earn the first retirement benefit. If the member is reemployed by an FRS participating employer during the 2nd through 12th months, the member's retirement benefits are suspended. After the 12^{th} month, the member may be reemployed without any restrictions on reemployment.

Several exceptions to the general reemployment restrictions have been enacted to assist educational personnel. Section 121.091(9)(b)3., F.S., provides, in pertinent part, that a district school board may reemploy a retired member as a substitute or hourly teacher, education paraprofessional, transportation assistant, bus driver, or food service worker on a noncontractual basis after the member has been retired for one calendar month. Reemployment of the retired member is limited to 780 hours during the first 12 months of his or her retirement. Employment beyond 780 hours requires written notice to the Division of Retirement and suspension of retirement benefits for the remainder of the first 12 months of retirement. After the first 12 months, the 780-hour limitation is eliminated and the member receives the full retirement benefit.

The reemployment does not affect the average final compensation or years of creditable service of the retiree or the DROP participant. Upon renewed membership in the FRS, the member is earning a second benefit (unrelated to the first benefit) and the employer must pay the applicable employer contributions as required in ss. 121.055(3), 121.071(1)(a) and (4), and 121.071, F.S.

Extended Participation in the Deferred Retirement Option Program

Members of the FRS may elect to participate in the Deferred Retirement Option Program (DROP) when they reach normal retirement age or at age 57, whichever is later. For purposes of the FRS, the member is a retiree; however, the retirement benefits are paid into the member's DROP account and earn 6.5 percent interest annually. The member may not receive the DROP accumulations until the member terminates employment with an FRS participating employer. Members may participate in DROP for no more than 60 months. If the member fails to terminate employment after the 60 months, the DROP accumulations are forfeited and the member is treated as if he had not retired (he receives additional service credit for those years in DROP and potentially an increased average final compensation).

Contribution Rates of the Florida Retirement System

FRS operates a traditional defined benefit pension plan. Under the defined benefit plan, employees are assured of an annuitized benefit at retirement calculated as a percentage of average final compensation. The defined benefit plan assumes all investment risk. The plan is designed to reward long-term employment at any of the employer-members of the FRS at all levels of state and local government. Pension portability is limited to an FRS employer.

In 2002, the Legislature enacted an alternative pension choice for participants in FRS to accommodate a more mobile workforce. The defined contribution investment plan allows participants to rollover their account upon separation from service with an FRS employer. Combined with an earlier vesting schedule, the plan affords a participant an opportunity to obtain retirement benefits without requiring long-term employment with an FRS employer. In addition, the plan authorizes participants to self-manage their accounts while assuming investment risk.

The Legislature changed the method of assessing employer payroll contributions by blending the defined benefit and defined contribution plans. The blended approach attempts to allow all FRS participating employers to benefit from any actuarial surplus in the FRS Trust Fund and to stabilize the net effect on the FRS rate structure due to the expected departure of the subsidized defined benefit plan participants. The Legislature estimated the number of participants who would elect the defined contribution plan and used the proportional share of payroll costs to establish the rate charged employers. Initial estimates anticipated a new plan enrollment of 178,000 employees and a cumulative asset transfer between $8 billion and $13 billion. In fact, as of December 6, 2002, 16,412 state and district school board employees had enrolled in the new plan and only $182 million of assets were transferred. Accordingly, the payroll contribution rates charged employers may require adjustment.

The table below shows the contribution rates effective July 1, 2002, and July 1, 2003, for each class or subclass as established by the 2002 Legislature.

Class	Current 07-01-02 Rates	Current 07-01-03 Rates
Regular Class	4.50%	9.87%
Special Risk Class	14.75%	22.89%
Special Risk Admin. Support Class	5.30%	12.58%
Elected Officers' Class – Judicial Subclass	14.60%	20.54%
Elected Officers' Class – Leg.-Atty.-Cab. Sub	8.15%	15.43%
Elected Officers' Class – County	10.60%	17.52%
Senior Management Service Class	4.80%	11.68%
Deferred Retirement Option Program (DROP)	8.00%	11.56%

These contributions are paid into the Florida Retirement System Contributions Clearing Trust Fund. Amounts necessary to pay the benefits due under the defined contribution program are transferred into the participants' accounts (for retirement benefits) and into the disability account of the Florida Retirement System Trust Fund (for disability benefits). The remainder of these contributions is transferred to the Florida Retirement System Trust Fund to pay for the benefits due under the defined benefit program.

Based on the 2002 Actuarial Valuation of the Florida Retirement System, the System has an actuarial surplus of $12.9 billion as of June 30, 2002. Actuarial liabilities increased by $5.5 billion during between July 1, 2001, and July 1, 2002, while the actuarial value increased only $3.9 billion during the same period.

In addition to the contribution rates paid by employers for retirement and disability benefits, s. 121.74, F.S., imposes an assessment of 0.15% of payroll to cover the administrative and educational expenses incurred by the State Board of Administration. This assessment generates approximately $32 million in FY 2002-03 to offset $26.6 million of anticipated expenses for the year.

On March 12, 2003, Milliman USA issued its separate valuation of the supplemental retirement plan for the Institute of Food and Agricultural Sciences (IFAS). The IFAS plan is a closed plan with 113 active participants remaining out of a total membership base of 236. The plan operates differently from a defined benefit plan in that its benefit structure is inversely related to salary. The IFAS plan was designed to act as a supplement to Social Security and as such provides a relatively greater benefit to lower salaried employees than to higher ones. The Milliman valuation indicated that this effect, coupled with lower asset performance and expected salary increases, required a payroll contribution rate increase from 6.96 percent to 13.83 percent.

Community College Optional Retirement Plan
In 1995, the Legislature enacted the Community College Optional Retirement Program. This program is a defined contribution plan in which certain executive personnel and faculty members of the community colleges may choose to participate in lieu of participation in the Florida Retirement System. This program allows for immediate vesting in both employer and employee contributions. Retirement benefits accrued under this program must be paid out in the form of an annuity.

III. Effect of Proposed Changes:

School Board Reemployment of Certain Retired Members
The bill expands the exceptions to reemployment of retired FRS members by authorizing a district school board to reemploy retired members as salaried instructional personnel after remaining off the payroll for 1 month. These instructional personnel and the noncontractual employees/retirees currently allowed limited reemployment will no longer be limited to only 780-hours during the first 12 months of retirement. This will allow those employees/retirees to receive both wages and retirement benefits during the first 12 months of retirement.

Extended Participation in DROP
The bill permits instructional personnel to participate in DROP for an additional three years subject to approval of the hiring authority. DROP was authorized by the 1997 Legislature and was effective in 1998. The first full five-year cohort of participants is scheduled for departure on June 30, 2003.

Community College Optional Retirement Plan
The enrollment period for the Community College Optional Retirement Program is extended from 60 to 90 days, and participants are permitted to receive full cash, or full or partial roll-over of their account balances in addition to an annuitized benefit.

Contribution Rates of Florida Retirement System
The table below shows by class and subclass the contribution rates currently scheduled to take effect July 1, 2003, and the rates established under this bill. The rates proposed for 07-01-03 assume the recognition of a portion of the actuarial surplus of the FRS Trust Fund to fully fund the current year costs of benefits earned during FY 2003-04. The rates proposed for 07-01-04 are set at the FRS's normal costs (a level percentage of payroll necessary to fund the benefits during the life of the system) without any recognition of surplus to subsidize the contributions by employers. The Regular Class rate effective July 1, 2004, is 0.11 percentage points above the normal cost in order to fund the increased benefits provided to reemployed instructional personnel.

	Current 07-01-03	Proposed 07-01-03	Proposed 07-01-04

Class	Rates	Rates	Rates
Regular Class	9.87%	6.18%	10.07%
Special Risk Class	22.89%	17.32%	22.15%
Special Risk Admin. Support Class	12.58%	8.71%	12.58%
Elected Officers Class – Judicial Subclass	20.54%	17.44%	20.70%
Elected Officers' Class – Leg.-Atty.-Cab. Su	15.43%	11.28%	15.48%
Elected Officers' Class – County	17.52%	14.02%	17.81%
Senior Management Service Class	11.68%	8.16%	11.59%
Deferred Retirement Option Program (DROP)	11.56%	8.00%	11.56%
IFAS	6.96%	13.83%	13.83%

This bill reduces the assessment used to pay the administrative and educational expenses incurred by the State Board of Administration. The rate is reduced from 0.15 percent of payroll to 0.10 percent of payroll, effective July 1, 2003. This new rate will generate roughly $17.3 million annually to offset $17.2 million of anticipated expenses.

The bill provides legislative findings that the act is an important state interest and that beneficiaries must be provided benefits under the retirement system that are adequate, fair, managed, administered, and funded in an actuarially sound manner as provided in law.

Effective Dates
The bill establishes a general effective date of July 1, 2003, and a special effective date of June 1, 2003 for the provisions of the bill relating to Deferred Retirement Option Program.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Article VII, Section 18, of the Florida Constitution, excuses local governments from complying with state mandates which impose additional fiscal burdens. Subsection (a) provides, "No county or municipality shall be bound by any general law requiring such county or municipality to spend funds or to take an action requiring the expenditure of funds," unless certain requirements are met. However, several exemptions and exceptions exist.

This bill requires cities and counties participating in the Florida Retirement System to expend additional funds because it will require them to make higher retirement contributions in FY 2004-05 and thereafter (absent other legislative action). However, subsection (a) contains an exception for laws which fulfill an important state interest and which apply to all persons similarly situated. This bill provides a determination and declaration of important state interest and treats all similarly situated FRS employers in the same manner. Thus, this bill meets the exception requirements of Art. VII, Section 18, of the Florida Constitution.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Article X, s. 14 of the State Constitution provides that benefits to members and beneficiaries of a public retirement or pension system must be prefunded in a sound actuarial manner. The bill provides for the state actuary to use an appropriate level of available excess assets of the Florida Retirement System Trust Fund to offset the difference between the normal costs of the FRS and the statutorily prescribed rates for FY 2003-2004.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None. The FRS is a noncontributory plan in which the employer pays all costs. The financial effects of the reemployment provisions and the extended participation in DROP are discussed below.

C. Government Sector Impact:

The bill permits the reemployment or retention of instructional personnel under circumstances favorable to both the employee and employer. The impacts from these changes can be estimated more accurately in direction than in magnitude since so much of the effect rests on a voluntary action of the departing or returning employee to stay in the active workforce. Based on preliminary estimates, the bill directs the state actuary to recognize up to $25 million of excess actuarial assets of the Florida Retirement System Trust Fund to provide the necessary funding for FY 2003-04. For future years, the state actuary will recommend increased contribution rates to fund these benefits.

The retention of personnel in DROP for another three years will increase payroll costs to the employer since the DROP payroll contribution rate is greater than the normal cost rate for active employees in the Regular Class. Since DROP employees will be at the upper end of the salary scale the cumulative effect will be to make these employees relatively more expensive to the payroll than their replacements. Moreover, while employees will have the benefit of receiving as many as eleven additional pension checks due to the forgiveness of the 12-month suspense period prior to reemployment, that also makes their pension life expectancy in the FRS eleven months longer. Any sustained return to the workforce under this provision may produce incrementally higher retirement costs that will be measured in subsequent plan valuations.

Each participant in DROP receives $74,406 in proceeds for each $1000 of initial monthly pension benefits for a 60-month participation. That benefit will increase proportionally with the addition of another three years' participation and the additive effects of compound interest. DROP pays a fixed rate of interest of 6.50 percent. The 10-year Treasury Bill is paying less than 4.00 percent. In a sustained low-interest rate environment the cumulative effect of this fixed DROP rate and the inability of the FRS to meet its expected 8 percent rate of return will produce additional negative cash flow on the FRS Trust Fund.

The use of earned sick leave is partially a function of age. A workforce policy which targets older workers for employment will have to contend with increased use of leave simply as a normal function of aging. This loss of productive attendance will have to be assessed by the employer in its use of these provisions and in its use of substitute personnel. In addition, the employer must assess the effect of the use of such targeted workforce additions on its other benefit plans. Employers across the nation have to contend with escalating health insurance costs as children of World War II-era parents begin their departure from the active workforce. There will be some additional expense to be borne by the employer for the claims experience of these renewed employees. For employees without affordable or accessible post-retirement insurance coverage, however, such a reemployment opportunity will permit them to shift the burden of this premium by seeking coverage in their employer's benefit plan.

With the enactment of this legislation, the revenues expected to flow into the Florida Retirement System in FY 2003-04 will be reduced by approximately $900 million. While the legislation does not expend additional funds from the Florida Retirement System Trust Fund, the bill does direct the state actuary to "recognize" a portion of the excess actuarial assets to offset the costs associated with setting the contributions below normal costs for FY 2003-04. The total amount of surplus to be recognized to offset such costs is approximately $900 million. An additional $25 million of surplus may be recognized to offset the costs for FY 2003-04 associated with increasing benefits for reemployed instructional personnel.

Comparing the contribution rates effective July 1, 2003, under current law to the rates established in this bill, employers participating in the Florida Retirement System will enjoy a reduction in retirement costs for FY 2003-04. The reductions by employer group are noted below:

State agencies	$181.4 million
State Universities	35.1 million
Community Colleges	25.7 million
School boards	375.0 million
Counties	247.8 million
Other	39.4 million
TOTAL	$904.5 million

VI. Technical Deficiencies:

None.

VII. Related Issues:

Because DROP is a contract between the hiring authority and the participant, it will be necessary to have this section of the bill become effective as soon as possible. This will give affected employers time to notice participants who may be planning to terminate.

VIII. Amendments:

None.