

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 789 Florida Retirement System
SPONSOR(S): Johnson
TIED BILLS: None **IDEN./SIM. BILLS:** None

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) State Administration		Williamson	Everhart
2) Appropriations			
3)			
4)			
5)			

SUMMARY ANALYSIS

The current employer contribution rates to the Florida Retirement System Trust Fund are: Regular Class – 6.18%, and Special Risk Class – 17.32%. This bill increases the FRS contribution rate for the Special Risk Class from 17.32% to 19.46% (+2.14%).

This bill amends the definition of “average final compensation” (AFC) to provide that the AFC for members of the Special Risk Class is calculated using the average of the highest three fiscal years’ salaries, instead of the average of the five highest fiscal years’ salary. The same applies when calculating the AFC for in-line-of-duty disability benefits for such members.

This bill funds the benefit increase by an employer-paid increase to the FRS Trust Fund and provides a declaration of important state interest. Such increase is applicable to the Special Risk Class. The estimated negative fiscal impact to the state is \$18,705,000 in FY 04-05, \$19,640,000 in FY 05-06, and \$20,622,000 in FY 06-07. The estimated negative fiscal impact to local governments is \$43,299,000 in FY 04-05, \$45,464,000 in FY 05-06, and \$47,737,000 in FY 06-07. See “FISCAL COMMENTS” section for additional details.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h0789.sa.doc
DATE: March 17, 2004

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. DOES THE BILL:

- | | | | |
|--------------------------------------|------------------------------|--|---|
| 1. Reduce government? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. Lower taxes? | Yes <input type="checkbox"/> | No <input checked="" type="checkbox"/> | N/A <input type="checkbox"/> |
| 3. Expand individual freedom? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. Increase personal responsibility? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. Empower families? | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a “no” above, please explain:

This bill could cause local governments to increase local taxes in order to cover the retirement benefit proposed by this bill.

B. EFFECT OF PROPOSED CHANGES:

Background

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits to more than 600,000 active and 200,000 retired members and beneficiaries of its more than 800 employers.¹ The active membership of the FRS is divided into five membership classes: Regular Class; Special Risk Class; Special Risk Administrative Support Class; Elected Officers' Class; and Senior Management Service Class. Each class is separately funded based upon the costs attributable to the members of that class.

The Special Risk Class was created to recognize that persons employed in certain categories of law enforcement, firefighting, criminal detention, and emergency medical care positions must, as an essential function of their positions, perform work that is physically demanding or arduous, or work that requires extraordinary agility and mental acuity. As persons in such positions age, they may not be able to continue performing their duties without posing a risk to the health and safety of themselves, the public, and their coworkers. In response, the Legislature established the Special Risk Class to permit such employees to retire at an earlier age and with less service without suffering economic deprivation.²

Special Risk Class membership differs from Regular Class membership in the following ways:

- Special Risk Class members earn retirement credit at the rate of 3% of average final compensation (AFC) for each year of service, as opposed to the 1.60%-to-1.68% credit per year of service earned by Regular Class members.
- Special Risk Class members qualify for normal retirement at an earlier age (age 55 v. age 62) or with fewer years of service (25 years v. 30 years) than Regular Class members.
- Special Risk Class members who are totally and permanently disabled in the line of duty qualify for a 65% minimum option 1 benefit payment compared to Regular Class members similarly disabled who qualify for a 42% minimum option 1 benefit payment.

¹ Department of Management Services 2004 Substantive Bill Analysis, HB 789, February 26, 2004.

² Section 121.0515(1), F.S.

Currently, the AFC is calculated using the average of the five highest fiscal years of salary (salary earned from July 1-June 30). A member's years of creditable service at retirement are multiplied by the accrual rate,³ which is then multiplied by the AFC to derive the Option 1 annual retirement benefit.

Effect of Bill

This bill amends the definition of "average final compensation" to provide that the AFC for members of the Special Risk Class is calculated using the average of the highest three fiscal years' salaries, instead of the average of the five highest fiscal years'. The same applies when calculating the AFC for in-line-of-duty disability benefits for such members.

This bill increases the FRS contribution rates for the Special Risk Class from 17.32%⁴ to 19.46% (+2.14%). It also provides a declaration of important state interest.

C. SECTION DIRECTORY:

Section 1 amends s. 121.021(24), F.S., changing the definition of "average final compensation" for members of the Special Risk Class.

Section 2 increases the contribution rate for the Special Risk Class.

Section 3 declares a public purpose for this bill.

Section 4 provides an effective of date July 1, 2004.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

This bill does not create, modify, or eliminate a state revenue source.

2. Expenditures:

Without a current actuarial study, actual costs are unknown. Based on FRS Special Study 2001h by Milliman USA, Inc., completed April 9, 2001, a 2.14% increase in the Special Risk contribution rate would result in these estimated costs:⁵

Year 1	Year 2	Year 3
<u>FY 04-05</u>	<u>FY 05-06</u>	<u>FY 06-07</u>
\$18,705,000	\$19,640,000	\$20,622,000

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

This bill does not create, modify, or eliminate a local revenue source.

³ The accrual rate is the percentage value awarded for each year of service as determined by the member's class of membership.

⁴ Effective July 1, 2004, the employer contribution rate for Special Risk Class members will increase to 22.15%. Section 121.71(3), F.S.

⁵ Department of Management Services 2004 Substantive Bill Analysis, HB 789, February 26, 2004.

2. Expenditures:

Without a current actuarial study, actual costs are unknown. Based on FRS Special Study 2001h by Milliman USA, Inc., completed April 9, 2001, a 2.14% increase in the Special Risk contribution rate would result in these estimated costs:⁶

Year 1	Year 2	Year 3
<u>FY 04-05</u>	<u>FY 05-06</u>	<u>FY 06-07</u>
\$43,299,000	\$45,464,000	\$47,737,000

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

If a tax increase is required to fund the retirement upgrade provided in this bill, persons in the private sector will be affected by that increase.

D. FISCAL COMMENTS:

Changing the AFC calculation for members of the Special Risk Class from a 5-year average to a 3-year average would improve retirement benefits for members of that class who are potential retirees (and their beneficiaries). An increase in retirement contributions for that class of membership is required to properly fund this improved benefit. Special Study 2001h was prepared to project the cost of this benefit enhancement if it were applied to all classes of FRS membership. The required rate increases as a result of that study are listed below:

Rate Increase Resulting From Change in AFC from 5 Years to 3 Years, based on FRS Special Study 2001h prepared by Milliman USA, Inc.

Class:	Regular	SMSC	Sp.Risk Regular	Sp.Risk Adm.	Judges	Leg.	County Offcs
Rate Increase:	1.06%	1.45%	2.14%	1.67%	1.87%	1.79%	1.66%

The actual cost for this benefit improvement cannot be known without a new special study to account for the specifics of this bill, the Special Risk Class plan changes (such as 6-year vesting, 3% accrual rate, 65% in-line-of-duty disability benefits) that have occurred since this study, and the changes in class demographics and other membership experience that may have occurred. However, for information only, the estimated cost based on the increase specified by this bill as applied to current payrolls is shown in the "FISCAL IMPACT ON STATE GOVERNMENT" and "FISCAL IMPACT ON LOCAL GOVERNMENTS" sections of this analysis.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision appears to apply because this bill requires the counties or cities to spend funds or take an action requiring the expenditure of funds; however, an exception applies. The bill provides a declaration of important state interest and similarly situated persons are all required to comply.

⁶ *Id.*

2. Other:

This bill could raise constitutional concerns if an actuarial study is not performed and this bill becomes law. An actuarial study is needed to determine the fiscal impact of this bill. Without knowing the fiscal impact, the state could be in violation of Art. X, s. 14 of the Florida Constitution.

Article X, s. 14, Florida Constitution

Since 1976, the Florida Constitution has required that benefit improvements under public pension plans in the State of Florida must be concurrently funded on a sound actuarial basis, as set forth below:

SECTION 14. State retirement systems benefit changes.--A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not after January 1, 1977, provide any increase in the benefits to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis.

Part VII of chapter 112, F.S.

Article X, s. 14 of the Florida Constitution is implemented by statute under part VII of chapter 112, F.S., the "Florida Protection of Public Employee Retirement Benefits Act," which establishes minimum standards for the operation and funding of public employee retirement systems and plans in the State of Florida. The key provision of this act states the legislative intent to "prohibit the use of any procedure, methodology, or assumptions the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers."

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

This bill does not specify whether an FRS member must belong to the Special Risk Class at the time of his or her retirement to qualify for the three year AFC calculation. It could be interpreted to mean that an FRS-covered employee who was a member of the Special Risk Class at any time in his or her career would be eligible for the three year AFC calculation.

On page 2, line 48, of this bill, a provision is made for increasing the rate "set forth in s. 121.071(3), Florida Statutes, for the Special Risk Class" to fund the bill. This subsection no longer includes any retirement contribution rates, but includes instead a reference to s. 121.71, F.S., the section which provides for uniform rates applicable to both the FRS Pension Plan and the FRS Investment Plan.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

Not applicable.