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.)

Prepared By: Governmental Oversight and Productivity Committee

BILL: CS/SB 992

SPONSOR: Governmental Oversight and Productivity Committee and Senator Smith and others

SUBJECT: Retiree Health Insurance Subsidy

DATE: April 26, 2005 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Rhea	Wilson	GO	**Fav/CS**
2.			WM	
3.				
4.				
5.				
6.				

I. Summary:

The bill would permit participants in the Deferred Retirement Option Program (DROP) to receive additional credit toward a health insurance subsidy benefit based on their employment while in DROP if they would not otherwise be eligible for the maximum retiree Health Insurance Subsidy (HIS) payment available beginning January 1, 2006. This increase would be $5 for each year of creditable service, with a minimum of $30 but not more than $150 per month. This increased subsidy would benefit primarily two groups: Special Risk Class Retirees, who qualify for normal retirement with 25 years of service, and any other retirees who enter DROP with less than 30 years of creditable service.

The bill also amends s. 121.091(4), F.S., to provide that certain special risk members who are catastrophically injured as defined in s. 121.091(4), F.S., in the line of duty are to be considered totally and permanently disabled and unable to render useful and efficient service as an officer, unless the administrator can provide competent medical evidence that the officer is able to render useful and efficient service as an officer. In order to fund the benefits, effective July 1, 2005, the contribution rate that applied to the Special Risk Class of the defined benefit program of the FRS is increased by 0.03 percentage points. The bill also raises the contribution rate that applies to the Special Risk Administrative Support class of the defined benefit program of the FRS by 0.20 percentage points.

This bill amends section 112.363 of the Florida Statutes.

II. Present Situation:

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing annuitized defined benefit and equity-based defined contribution retirement benefits to the more than 620,000 active and 210,000 retired members of its 840 state and local government employer members. The FRS is the fourth largest public retirement system in the United States, covering 633,489 active employees, 217,158 annuitants (retirees and their surviving beneficiaries), and 28,280 participants in the Deferred Retirement Option Program (DROP).

The active membership of the FRS is divided into five membership classes: (1) Regular Class, which consists of 558,051 members (88.1% of the membership); (2) Special Risk Class, which includes 66,861 members (10.6% of the membership); (3) Special Risk Administrative Support Class, which has 92 members (0.014% of the membership); (4) Elected Officers Class, which has 2,112 members (0.33% of the membership); and the Senior Management Service Class, which has 6,373 members (1.0% of the membership). Each class is separately funded based upon the costs attributable to the members of that class.

Normal Retirement Under the FRS Pension Plan - Under existing law, a member's normal retirement date determines when he/she initially qualifies to retire with full, unreduced benefits or first becomes eligible to participate in DROP. The age and career of service varies by membership class:

- Vested members of the Special Risk and Special Risk Administrative Support Classes may retire with full benefits at age 55, or with 25 years of special risk service, regardless of age. Up to 4 years of military service credit can be applied toward the 25 years of creditable special risk service if the retiring special risk member is age 52 or older and the military service credit is not claimed under any other system.
- Vested members of all other classes may retire with full benefits at age 62, or with 30 years of service in any class, regardless of age. Up to 4 years of military service credit can be applied toward the 30 years of creditable service if the military service credit is not claimed under any other system.

Teachers' Retirement System - In 1939, the Florida Legislature established the "Teachers' Retirement System of the State" under chapter 238, F.S., for persons serving as "teachers"[1] after July 1, 1936. Social Security coverage is not available to members under the TRS. The TRS is an employee-contributory plan. Although the plan has been closed to new members since 1970, it remains an active plan today. However, due to attrition, on June 30, 2004, there were just 141 active members and 6,854[2] retirees and annuitants in the TRS.

State and County Officers and Employees' Retirement System - In 1945, the Florida Legislature established three separate retirement systems for public employees: The Highway Patrol Pension Fund, the State Officers and Employees' Retirement System, and the County Officers and Employees' Retirement System. The systems for state and county employees were identical to each other in almost every respect, and in 1955 the Legislature consolidated the two systems, creating the State and County Officers' and Employees' Retirement System under

[1] Under chapter 238, "teacher" is defined as any member of the teaching or professional staff of various public schools (including vocational schools), state agency training schools, and tax-supported institutions of higher learning (universities and community colleges); any teacher-certified employee of the Department of Education or the retirement system itself; any full-time certified employee of an education-related nonprofit professional association or corporation; and any county school superintendent holding a valid teaching certificate.
[2] Count includes 798 TRS annuitants receiving survivor benefits from the Teachers' Retirement System (TRS SB).

chapter 122, F.S. In 1957, the Legislature integrated Social Security into the system, causing SCOERS to be split into two divisions. Those who rejected Social Security coverage went into Division A, while new employees and those who elected to receive Social Security coverage went into Division B (where they pay slightly higher contribution rates and receive lower benefit accruals). SCOERS is an employee-contributory plan. Although the plan has been closed to new members since 1970, it remains an active plan today. However, due to attrition, on June 30, 2004, there were just 12 active members and 1,507 retirees and annuitants in SCOERS.

Deferred Retirement Option Program (DROP) – The DROP program was established in July 1998. DROP allows eligible members of the FRS Pension Plan, TRS, or SCOERS to retire and begin accumulating monthly retirement benefits, plus interest, while they continue working. The retiring member's benefit is based upon his/her years of service at the time DROP participation begins. While in DROP, monthly retirement benefits accumulate in the FRS Trust Fund, earning tax-deferred interest, while the DROP participant continues to work without earning additional creditable service.[3]

To be eligible to participate in DROP, the member must qualify for normal retirement, by reason of age or length of service. Once a member qualifies for normal retirement, he/she has a limited time within which to elect to join DROP and a limited period to participate in the program. For most members, the DROP election window is a 12-month period[4] that begins when the member first qualifies for normal retirement, unless the member is eligible to defer the DROP election.[5] Similarly, for most members,[6] the period of DROP participation is limited to 60 months from the participant's normal retirement date or deferred eligibility date. Currently, no DROP participant earns additional service credit that would improve his/her potential future HIS benefit.

Health Insurance Subsidy (HIS) - A principal benefit feature of the FRS is its incorporation of a health insurance subsidy payment as an additive to the plan's retirement income features. Section 112.363, F.S., provides for a retiree health insurance subsidy (HIS) for retirees of the FRS, TRS, and SCOERS, to help them with the costs of maintaining health insurance coverage. A retiree must have satisfied the vesting requirements for his or her membership class, unless that person has retired due to disability and qualified for a regular or in-line-of-duty disability benefit or qualified for a disability plan. An FRS participant in the Pension Plan must have six

[3] Except for the annual 3% cost-of-living adjustments payable to all retirees, the DROP participant's benefit is effectively "frozen" upon entry into DROP.

[4] In 2001, the DROP law was amended to remove the 12-month time limit on DROP election for certain instructional personnel, allowing them to indefinitely postpone the decision to join DROP. Instructional personnel as defined under former s. 228.041(9)(a)-(d), F.S., could make the election to participate in DROP "at any time" after reaching their normal retirement date [today this definition is found at s. 1012.01(2)(a)-(d), F.S.].

[5] Certain retirees may qualify to defer the DROP election: A member who completes 30 years of service before reaching age 57 may defer the DROP election to anytime between completing 30 years of service and reaching age 57 (FRS special risk members who complete 25 years of Special Risk Class service before age 52 may defer DROP to age 52); elected officers in the FRS Elected Officers' Class may defer DROP until their next succeeding term of office after first reaching their normal retirement date and may participate for the lesser of 5 years or the length of that term; members who have covered employment in the FRS Special Risk Class as well as other employment covered by a different FRS membership class or plan may elect to participate in DROP upon reaching their normal retirement date for either class; and certain "instructional personnel" in grades K-12 may choose to enter DROP at any time after reaching their normal retirement date.

[6] In 2003, the program was modified to allow certain instructional personnel to extend their DROP period for up to an additional 36 months, for a potential total of 96 months in DROP, as long as they obtained the appropriate administrative approval.

years of service, and a participant in the Investment Plan must have one year of service, to be eligible for the HIS payment.

Participants in the Senior Management Service Optional Annuity Program and the State University System Optional Retirement Program are not authorized to receive the HIS benefit under s. 112.363, F.S.

Section 112.363, F.S., allows each FRS retiree to apply for and receive a subsidy payment equal to $5 per month per year of creditable service. For defined benefit, or Pension Plan participants, this payment is an itemized addition to the monthly retirement income check. For participants in the alternative defined contribution, or Investment Plan, an equivalent amount is added to their account.

The subsidy requires the applicant to demonstrate that there is an out-of-pocket post-retirement health insurance premium for the subsidy to apply. The participant must also separately apply for this additional benefit feature. An estimated 206,000 retirees or beneficiaries were receiving this benefit in March 2005. The benefit is paid by the imposition of an additional employer contribution rate of 1.11 percent, or 111 basis points,[7] on the employer active payroll. The contribution rate is imposed uniformly on all FRS retirement classes.[8]

HIS benefits are separately funded by required HIS contributions paid by all participating employers as a percentage of payroll for all active FRS, TRS, and SCOERS members. HIS contributions are deposited in a separate trust fund from which the HIS payments are funded. Since FY 2001/02, the HIS contribution rate has been 1.11% of payroll (*see s. 112.363, F.S.*). Unlike the retirement benefits paid under the FRS Pension Plan, TRS, and SCOERS, HIS benefits are not actuarially prefunded; that is, contributions are not set aside and invested during the members' careers to fund their future HIS benefits. The monthly HIS benefits paid to retirees are funded by contributions made as a percentage of the **active** members' payroll. This type of funding is sometimes referred to as "pay-as-you-go" funding. The bulk of the HIS contributions are immediately paid out as HIS benefits to eligible retirees and beneficiaries. To the extent that the contributions paid exceed the payments required, a reserve is established that earns interest. HIS funding is based on a short-term perspective (i.e., 3 years) — the HIS rate is not presumed to fund HIS benefits over the long term. If funds are ever insufficient to provide full HIS benefits to all recipients, contribution rates may be raised or HIS payments may be reduced or canceled. The Florida Legislature has increased the HIS payment amount three times since the subsidy was first established and raised the required HIS contribution rates five times to maintain sufficient revenues in the HIS Trust Fund to pay the benefits due. On June 30, 2004, 199,228 HIS recipients were receiving an average monthly HIS benefit payment of $104. For FY 2003/04, HIS benefit payments totaled $248,291,392.

[7] One basis point is .01%, or .0001.

[8] Regular, Special Risk, Special Risk Administrative Support, Senior Management, and Elected Officers, the latter inclusive of three subclasses of state officers, local government officers, and justices and judges.

III. Effect of Proposed Changes:

Beginning January 1, 2006, each eligible retiree of the defined benefit program of the FRS (or his or her beneficiary or a person who meets the definition of joint annuitant[9]), shall receive a monthly retiree health insurance subsidy payment equal to the number of years of creditable service[10] completed at the time of retirement, in addition to a maximum of 60 months the retiree participated in DROP, multiplied by $5. This subsidy may not be less than $30 or more than $150. Further, if there are multiple beneficiaries, the subsidy cannot be greater than the payment to which the retiree was entitled. Further, this provision expressly cannot reduce a health insurance subsidy amount for a person receiving a retiree health insurance subsidy payment on July 1, 2001.

The bill would amend s. 112.363, F.S., to permit up to 60 months of credit toward calculation of the HIS benefit during that time the retiree is participating in DROP, in some cases. This would benefit those members who enter DROP before completing 30 years of creditable service, primarily consisting of two groups: Retired members of the Special Risk and Special Risk Administrative Support Classes (all of whom qualify for normal retirement after 25 years of service or at age 55 if vested) and other retirees who started in covered employment at a later age and first qualified for normal retirement at age 62. Because participation in DROP is limited to those members who begin within the 12-month period after they first qualify for normal retirement (unless permitted by law to defer the election), under current law, many members enter DROP with less than 30 years of service — and receive less than the maximum HIS benefit.

Based on DROP participation data available as of June 30, 2004, slightly more than 42 percent of the active DROP participants retired and entered DROP with less than 30 years of creditable service (and are therefore eligible for less than the $150 maximum monthly benefit amount allowed under law). The tables below illustrate the numbers of active DROP participants potentially affected:

[9] Section 121.021(28), F.S., defines “joint annuitant” to mean any person designated by the member to receive a retirement benefit upon the member’s death who is: (a) the spouse of the member; (b) The member’s natural or adopted child who is under age 25, or is physically or mentally disabled and incapable of self-support, regardless of age; or any person other than the spouse for whom the member is the legal guardian, provided that such person is under age 25 and is financially dependent for no less than one-half of his or her support from the member at retirement or at the time of death of such member, whichever occurs first; or (c) A parent or grandparent, or a person age 25 or older for whom the member is the legal guardian, provided that such parent, grandparent, or other person is financially dependent for no less than one-half of his or her support from the member at retirement or at time of the death of such member, whichever occurs first.

[10] “Creditable service” of any member means the sum of his or her past service, prior service, military service, out-of-state or no-FRS in-state service, workers’ compensation credit, leave-of-absence credit and future service allowed within the provisions of this chapter if all required contributions have been paid and all other requirements of this chapter have been met. However, in no case shall a member receive credit of r more than a year’s service during any 12-month period.

CREDITABLE SERVICE OF DROP PARTICIPANTS	
Years of Creditable Service of DROP Participants	Number of Participants
Less than 20 Years of Creditable Service	6,328 (21.5%)
Between 20 and 25 Years of Creditable Service	2,320 (8.1%)
Between 25 and 30 Years of Creditable Service	3,420 (11.9%)
Thirty or More Years of Creditable Service	16,595 (57.9%)

DROP PARTICIPANTS, CREDITABLE SERVICE BY CLASS AND PLAN			
Class/Plan	All DROP Participants	Count < 30 Years of Service	Percent < 30 Years of Service
FRS – Regular Class	24,840	9,401	37.85%
FRS – SMSC	326	53	16.26%
FRS – Special Risk Class	2,921	2,540	86.96%
FRS – Special Risk Administrative Support	22	10	45.45%
FRS Elected Officers' Class	171	61	35.67%
TRS	376	3	0.79%
SCOERS	7	0	0.00%
All Classes/Plans	28,663	12,068	42.10%

The bill also amends s. 121.091(4), F.S., to provide that a special risk member who is an officer as defined in s. 943.10(1), (2), or (3), F.S.; a firefighter as defined in s. 633.30(1), F.S.; an emergency medical technician as defined in s. 401.23(11), F.S.; or a paramedic as defined in s. 401.23(17), F.S., who is catastrophically injured as defined in s. 121.091(4), F.S., in the line of duty is considered totally and permanently disabled and unable to render useful and efficient service as an officer, unless the administrator can provide competent medical evidence that the officer is able to render useful and efficient service as an officer.

Further, the bill provides that, effective July 1, 2005, in order to fund benefits provided in s. 121.091, F.S., the contribution rate that applied to the Special Risk Class of the defined benefit program of the FRS is increased by 0.03 percentage points.

The bill also raises the contribution rate that applies to the Special Risk Administrative Support class of the defined benefit program of the FRS by 0.20 percentage points.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Section 18, Article VII, of the State Constitution, states:

> 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 the legislature has determined that such law fulfills an important state interest and unless: funds have been appropriated that have been estimated at the time of enactment to be sufficient to fund such expenditure; the legislature authorizes or has authorized a county or municipality to enact a funding source not available for such county or municipality on February 1, 1989, that can be used to generate the amount of funds estimated to be sufficient to fund such expenditure by a simple majority vote of the governing body of such county or municipality; the law requiring such expenditure is approved by two-thirds of the membership in each house of the legislature; the expenditure is required to comply with a law that applies to all persons similarly situated, including the state and local governments or the law is either required to comply with a federal requirement or required for eligibility for a federal entitlement, which federal requirement specifically contemplates actions by counties or municipalities for compliance. . . .

The subsidy is payable by all employers in the FRS, which includes local governmental entities.

The bill contains an important state interest clause that the duties of certain personnel are vital to public safety and it is a proper and legitimate state purpose to provide a uniform retirement system for those personnel.

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:

On June 30, 2004, 199,228 HIS recipients were receiving an average monthly HIS benefit payment of $104. For FY 2003/04, HIS benefit payments totaled $248,291,392.

Based on both terminated and active DROP participants as of June 30, 2004, who entered DROP with less than 30 years of creditable service (and are therefore eligible under current law for less than the maximum allowable HIS benefit), The Division of Retirement has calculated a rough estimate of the additional annual HIS payments as of August 1, 2005, as shown in the following charts:

Terminated DROP Participants **Estimated Increased HIS Payments under SB 992** **for DROP Time Completed as of Termination Date** ***(assumes HIS credit given for DROP, up to total of $150/month)***				
Fiscal Year DROP Terminated	Count of DROP Terminants in FY with < 30 Yrs Service	Average Extra Years* HIS Possible (*rounded)	Average Annual Added HIS, per Participant	Total Annual Added HIS
7/1/99 – 6/30/00	3,146	0.38	$23.04	$72,479
7/1/00 – 6/30/01	1,920	1.25	$74.87	$143,747
7/1/01 – 6/30/02	2,495	1.62	$97.26	$242,675
7/1/02 – 6/30/03	5,315	2.83	$169.93	$903,182
7/1/03 – 6/30/04	3,139	3.73	$223.67	$702,105
			TOTAL:	**$2,064,189**

Active DROP Participants — Estimated Increased HIS Payments under SB 992 for DROP Time Payable as of 8/1/2005 ***(assumes HIS credit given for DROP, up to total of $150/month)***					
Creditable Service at DROP Entry	Count of DROP Participants on 6/30/04	Avg Years in DROP	Extra HIS Coverage Possible	Average Added Annual HIS, per Participant	Total Added Annual HIS* on 8-1-05
less than 20 years	6,328	2.65	5 years	$159.00	$1,006,152
20 - 25 years	2,320	2.53	5 years	$151.80	$352,176
25 - 26 years	1,210	2.75	4 to 5 years	$165.00	$199,650
26 - 27 years	627	2.84	3 to 4 years	$170.40	$106,841
27 - 28 years	567	2.74	2 to 3 years	$164.40	$93,215
28 - 29 years	548	2.74	1 to 2 years	$120.00	$65,760
29 - 30 years	468	2.59	0 to 1 year	$60.00	$28,080
				TOTAL:	**$1,851,874**

Annual increased costs for HIS (roughly $3.9 million plus unknown costs for future DROP participation) would become realized as affected DROP participants end DROP, terminate employment, and become eligible to receive their HIS benefits. The effect would be to deplete the HIS Trust Fund more rapidly than projected, which would lead to an increase in HIS contribution rates, or the reduction or elimination of HIS payments, earlier than would otherwise be projected. To cover the increased HIS payments for terminated DROP participants and active DROP participants as of July 1, 2005, and keep the fund reserve fundamentally stable, the Division of Retirement notes that HIS rates should be increased by 0.02% — from 1.11% to 1.13% — of gross pay for each covered member. This level of increase would not, however, address future impact due to increased HIS payments for members who enter DROP on and after July 1, 2004.

While the bill provides for a potential increase in HIS benefits for about 42 percent of these DROP participants, no provision is made to increase the HIS contribution rate. The HIS is not actuarially prefunded, but is funded on a pay-as-you-go basis. According to the Department of Management Services, Division of Retirement, the contributions paid into the Retiree Health Insurance Trust Fund are sufficient to provide a few months' reserve[11] in benefits. Improvement of benefits potentially payable to about 42 percent of existing DROP participants would result in an *immediate* decrease in the benefit reserve. The

[11] According to a projection model estimating fund sufficiency based on current benefit levels and assumptions with respect to growth in HIS benefit recipients and trust fund earnings, if the HIS contribution rate remains unchanged at 1.11% and the HIS benefit level does not change, the HIS Trust Fund currently holds a reserve that is projected to range from 7.2 months in July 2005 to 5.7 months in June 2008.

amount of the decrease is unknown. For the future, it is not possible to predict the number of eligible members who would choose to participate in DROP, or the affected DROP participants who would choose to remain in the program, or how long they would remain.

Based on active DROP participants as of June 30, 2004, about 42 percent entered DROP with less than 30 years of creditable service. Improving the HIS benefits payable to eligible retirees would reduce the HIS Trust Fund reserve. The total amount of the decrease is unknown as it is not possible to predict the number of eligible members who will choose to participate in DROP, or how much their DROP participation would improve their future HIS benefit. However, there is a known increase in annual outflow for enhancing the HIS benefits payable to current and former DROP participants who would qualify for the benefit improvement based on their participation as of July 1, 2005. As the HIS reserves become depleted, it would be necessary to either raise the HIS contribution rates paid by participating employers or reduce or discontinue the subsidy paid to retirees.

As drafted, the bill appears to apply not only to future retirees, but to all retired members and beneficiaries who are currently receiving benefits, if the member participated in DROP and entered the program with less than 30 years of creditable service. The Division of Retirement would have to evaluate all current and former DROP participants to assess the cost for upgrading the HIS benefit and increase the amounts payable to these annuitants.

Further, effective July 1, 2005, in order to fund benefits provided in s. 121.091, F.S., the contribution rate that applied to the Special Risk Class of the defined benefit program of the FRS is increased by 0.03 percentage points. The bill also raises the contribution rate that applies to the Special Risk Administrative Support class of the defined benefit program of the FRS by 0.20 percentage points.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.