The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Governmental Oversight and Accountability Committee

BILL:	SPB 7042
INTRODUCER:	For consideration by the Governmental Oversight and Accountability Committee
SUBJECT:	Retirement
DATE:	February 10, 2009 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson		**Pre-meeting**
2.				
3.				
4.				
5.				
6.				

I. Summary:

Section 121.031, F.S., provides for an annual actuarial study of the Florida Retirement System and for a report of the results to the Legislature by December 31 each year. Thereafter, the Legislature establishes uniform contribution rates in law annually. Participating employers in the Florida Retirement System must make monthly contributions to fund the system.

The bill establishes the required employer payroll contribution rates for each membership class and subclass of the defined benefit plan of the Florida Retirement System retirement plan for the fiscal year beginning July 1, 2009.

The bill amends section 121.71, Florida Statutes.

II. Present Situation:

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits to the 600,000 active and 300,000 retired members and beneficiaries of some 1,000 state and local government public employers. Originally established in 1970 as the successor to the Teachers' Retirement System and the State, and County Officers' and Employees' Retirement System, the FRS is today a combination of five previously separate pension plans. Benefit payments are administered by the Department of Management Services through its Division of Retirement while investment management is undertaken by the Board of Administration. Established as a Section 401(a) government plan under the Internal Revenue Code, its benefits are exempt from federal taxation until received by the employee.

As a defined benefit plan, the FRS "Pension Plan" provides retirement income expressed as a percent of final pay. Participants accrue retirement credits based upon their eligibility in one of several membership classes. Years of creditable service multiplied by average final salary multiplied by the accrual rate for the membership class, plus up to 500 hours of annual leave, yield a monthly annuity benefit at normal retirement. The accrual rates range from 1.60 percent for the Regular Class to 3.33 percent for Justices and Judges. For most membership classes normal retirement occurs at the earlier attainment of 30 years' service or age 62. For public safety employees in the Special Risk Retirement and Special Risk Administrative Support Classes, normal retirement is the earlier attainment of age 55 or 25 years' service. Members seeking early retirement dates receive a five percent reduction in the benefit for each year below their normal age threshold.

All membership classes permit enrollment in a Deferred Retirement Option Program (DROP) under which a participant may extend employment for an additional five years - eight years for instructional personnel in district school boards - and receive a lump sum benefit at a fixed rate of interest for that additional service. Enrollment in DROP requires the participant to serve the employer with a deferred resignation from employment at the end of the period. The defined benefit plan includes a fixed, annual cost-of-living adjustment of three percent.

The 2000 Legislature enacted sweeping changes to the FRS by creating the Public Employees Optional Retirement Program (Part II of ch. 121, F.S.), an alternative defined contribution or "Investment Plan" for its members. While a defined benefit plan provides an annuitized monthly benefit expressed as a percent of final pay, a defined contribution plan gives members an equity interest in their employer's payroll contributions and their earnings, although it does not assure a guaranteed result. Generally, a defined benefit plan rewards career employment as its annuitized benefits become more generous with longer service. A defined contribution plan works best for those who value public service for only short employment experiences or who prefer to manage their own investments. DROP enrollment is unavailable in the Investment Plan due to the incompatibility of plan designs.

Management employees and instructional employees in higher educational units are also permitted to enroll in one of three other separate optional annuity programs that exist outside of FRS authority.

All state employees are provided with the enrollment opportunity within the first 30 days of retirement to receive post-retirement health insurance coverage and, along with it, a financial stipend to cushion the premium burden. That health insurance subsidy is a $5 per year of service stipend paid monthly to each retiree. The upper limit is 30 years' service or $150 a month. Florida law requires all members seeking to keep their health insurance benefits during their retirement to pay the full, active employee premium, unreduced by employer contribution.

Section 121.031(3), F.S., provides that the administrator[1] shall perform an actuarial study of the system at least annually and must report the results to the Legislature by December 31 each year.

[1] Section 121.025, F.S., designates the secretary of the Department of Management Services as the administrator of the retirement and pension systems.

By law,[2] the Legislature commissions a separate second opinion of that valuation that is performed by the Office of Program Policy Analysis and Governmental Accountability (OPPAGA).

In 1998, the FRS Trust Fund began to experience surpluses of assets over liabilities for the first time in its history. The ending actuarial surplus for the current valuation year is approximately $8.2 billion. It has been the recent custom to recognize a portion of these excess actuarial assets as a credit toward the payroll contribution rate structure. Sections 121.031 and 121.0312, F.S., establish a method for the calculation and a recommended rate structure for an adequate level of funding of the FRS that permits use of a rate stabilization mechanism. That mechanism recognizes a portion of any surplus that exceeds nominal percentages of actuarial liabilities for the smoothing of wide fluctuations in employer contributions in any one year. The table below reports the unsubsidized or normal cost rates and compares them with the actual rates charged for the current and forthcoming fiscal year. In the absence of passage of legislation changing the current rate subsidy, the normal cost rates are set in default. While the rate stabilization mechanism is instructive for the setting of rates, the Legislature is under no obligation to adhere to it and has for the past few years used amounts in excess of the formula to subsidize the normal cost structure of FRS.

The principal economic assumptions used in the calculation of the funding base of the FRS are investment earnings of 7.75 percent; post-retirement benefit increases of 3.00 percent; salary growth of 4.00 percent (inclusive of 3.00 percent inflation); and membership growth of 0.0 percent. Benefit payments further assume 139 hours of annual leave used to enhance or "spike" the final benefit. The actuarial valuation method is *entry age normal* which provides a present value of expected benefits expressed as a level percentage of an individual's salary between entry age and assumed exit.

At five year intervals the plan is subject to an experience study in which the morbidity and mortality of plan members is assessed. That study will commence at the beginning of the 2010 fiscal year and will set the experience parameters through the year 2014. All special actuarial studies commissioned over the previous five-year period will be rendered null and void and will have to be reset based upon the results of the experience study.

III. Effect of Proposed Changes:

Section 1. The bill amends s. 121.71, F.S., to set the employer payroll contribution rates for the defined benefit plan of the Florida Retirement System. For comparison purposes, the following rates compare the current fiscal year rates with those recommended by the consulting plan actuary for normal cost and those upon which the Governor's recommended budget is based. Normal cost rates do not recognize any excess assets.

[2] Section 112.658, F.S.

FRS Actual and Proposed Contribution Rates
For Fiscal Years 2009 and 2010

Retirement Class	SPB 7042	Current Law (FY 2009)	Default Normal Cost Rate (FY 2010)
Regular	TBD	8.69	9.60
Special Risk	TBD	19.76	22.03
Special Risk, Admin.	TBD	11.39	11.98
Elected State Officers	TBD	13.32	14.56
Elected, Judges	TBD	18.40	20.37
Elected, County Off.	TBD	15.37	17.06
Senior Management	TBD	11.96	13.36
DROP	TBD	9.80	10.96

Section 2. The bill provides a declaration of important state interest in compliance with s. 18, Art. VII, State Constitution.

Section 3. The bill takes effect upon becoming a law.

<u>Other Potential Implications</u>: There is no specific requirement that the Legislature enact a bill setting the contributions unless it determines an amount different from the default rate is warranted. The effect of no bill passing is to have the default rates in effect for the FY 2010 plan year and to not recognize any of the excess actuarial assets as a rate deflator. This would have the effect of passing addition payroll costs to the member employers but more accurately align the long term funding costs of the FRS with expected experience.

IV. Constitutional Issues:

The bill provides a statement of important state interest to effect compliance with s. 18, Art. VII, State Constitution.

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Article X, section 14, State Constitution, and Part VII of ch. 112, F.S., separately require all public sector pension plans to prefund all promised pension benefits in a sound actuarial manner to avoid the intergenerational transfer of unfunded risk.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

The draft bill does not provide a statement of the rates to be placed into effect for the designated fiscal years. By custom, these rates are established later in the Regular Session and reflect a consensus on funding requirements consistent with the budget position taken in the General Appropriations Act.

VII. Related Issues:

This bill accompanies the General Appropriations Act and legislation implementing that act, and fixes the employer payroll costs on which appropriated sums are provided. Many of the employer-members of the FRS, particularly district school boards, community colleges, and state universities, have their operating budgets determined by the shared revenues distributed through the General Appropriations Act, specifically the Florida Educational Finance Program and the Community College Program Fund.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.