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: CS/SB 1832

INTRODUCER: Governmental Oversight and Accountability; and Governmental Oversight and Accountability

SUBJECT: Retirement

DATE: March 11, 2009 REVISED:

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

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	X	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

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 multi-employer Florida Retirement System public pension plan for the fiscal year beginning July 1, 2009.

The bill transfers the Division of Retirement in the Department of Management Services to the State Board of Administration and provides for the preparation of conforming legislation for the 2010 Regular Session of the Legislature.

The bill amends ss. 20.22, 121.021, 121.025, 121.1905, and 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 680,000 active and 296,000 retired members and beneficiaries of its nearly 1000 state and local government public employers.[1] 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.[2] 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, pension 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.

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[1] As of July 1, 2007, the membership was comprised of 683,811 active members and 274,842 retired members. There were 31,562 DROP participants.

[2] The remaining systems are the former Highway Patrol Retirement Plan, the Judicial Retirement System, and, in 2007, the Supplemental Pension Plan at the University of Florida's Institute of Food and Agricultural Sciences.

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 state 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[3] shall perform an actuarial study of the system at least annually and must report the results to the Legislature by December 31 each year. The annual valuation was received in December 2008 for the FRS plan year ending the prior June 30.[4] By law,[5] the Legislature commissions a separate second opinion of that valuation which 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, adjusted for age and longevity; and, membership growth of 0.0 percent. Benefit payments further assume 139 hours of annual leave, or 1.66% of the benefit, are 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 are assessed. That study will commence at the beginning of the 2010

[3] Section 121.025, F.S., designates the Secretary of the Department of Management Services as the administrator of the retirement and pension systems.
[4] Milliman, "Florida Retirement System Actuarial Valuation as of July 1, 2008."
[5] Section 112.658, F.S.

fiscal year and will set the experience parameters through the year 2014. Special actuarial studies commissioned over the previous five years based upon mortality and morbidity patterns determined by the 2003 study will be rendered null and void.

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. Normal cost rates do not recognize any surplus or excess actuarial assets.

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

Retirement Class	SB 1832 (2009) (%)	Normal Cost Rates Based on 2008 Valuation for FY 2010
Regular	8.69	9.63
Special Risk	19.76	22.11
Special Risk, Admin.	11.39	12.10
Elected State Officers	13.32	15.20
Elected, Judges	18.40	20.65
Elected, County Off.	15.37	17.50
Senior Management	11.96	13.43
DROP	9.80	10.96

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

Sections 3, 4, 5, and 6. The committee substitute amends ss. 20.22, 121.021, 121.025, and 121.1905, F.S., to relocate the Division of Retirement, the administrative entity responsible for the payment of benefits in the Florida Retirement System, in the Department of Management Services with the Board of Administration.

Section 7. The transfer of the Division of Retirement uses a type two process, authorized by s. 20.06, F.S., in which the receiving organization retains the ability to integrate like functions and positions.

Section 8. The Division of Retirement is transferred using a type two process, as provided in s. 20.06, F.S., in which the receiving organization retains the structure but retains the ability to integrate like functions and personnel.

Section 9. The bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

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

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. As is discussed, below, the changes contemplated in this year's rate bill impact this constitutional requirement.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

The contribution rates have been increasing slightly each year and are a direct function of available excess actuarial assets, mortality and morbidity experience of the participating employees, investment return, and projected salary and inflation experience.

On March 3, 2003, a study group composed of representatives of the Division of Retirement and the Board of Administration issued a report evaluating a legislative proposal to merge both organizations.[6] The report identified several administrative matters that would require attention for the merger to proceed. It reported that such an organizational merger would improve coordination, achieve a common enterprise focus on benefit administration, and provide a unitary organizational model for pension investment and management. The report also evaluated items not supportive of the

[6] State Board of Administration of Florida, *Report of the SBA/DOR Joint Team on Merger*. Tallahassee, FL: March 3, 2003, 12 pp.

merger as a changed focus from strategic investment to tactical operations; heavily concentrating organizational focus on one investment portfolio; and, a dual budget authority since the SBA is funded in a non-operating budget.

The overall conclusion reached by the work group was reported as follows:

> "In the team's judgment, the consequences of merger may be essentially neutral in the short term and positive in the long term. The *direct* financial costs that have been quantified (Table 1) combined with the upside risk on payroll expense are likely to be offset by savings with respect to information technology support. In the long run, however, we expect the net impact of merger to be positive based on *indirect* gains from post-merger re-engineering and from a singular executive focus on all aspects of the Florida Retirement System.[7]"
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> The Report identified recurring costs of $249,908 and non-recurring costs of $1,762,200. The impact would have to be reassessed in light of changes to salaries and benefits, rental rates for the respective locations, and the reduction in administrative support, or "back office" costs resulting from the combination of like functions. The areas in which future costs savings were expected to occur, but could not be precisely estimated, were in information technology, mass communications, and educational support activities.

VI. Technical Deficiencies:

None.

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.

By letter dated December 18, 2008, the consulting actuary to the Florida Retirement System reported the calculation of recommended "blended" rates for the pension plan based upon its calculation of the weighted average rates for the pension and investment plans, using all available excess actuarial assets as provided by the statutory formula:

[7] *Report*, p. 10.

FRS Blended Contribution Rates (%), FY 2008-2009

Fiscal Year	Regular	Special Risk	Special Risk, Adm.	Judicial	Elected State	Elected County	Senior Mgmt.	DROP
2009	**8.35**	**20.77**	**10.85**	**19.26**	**13.81**	**16.18**	**11.81**	**11.14**

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

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

CS by Governmental Oversight and Accountability on March 11, 2009:
The Committee Substitute restates the rates for the current fiscal year as the rates for the FY 2010 fiscal year and adjusts the normal cost, or default, rates for the FY 2011 as those recommended by the consulting actuary in the December 2008 report.

It transfers the Division of Retirement in the Department of Management Services to the Board of Administration and provides for the integration of common, post-merger functions.

The bill also provides for the development of conforming legislation in the 2010 Regular Session for the correction of statutory cross references.

B. Amendments:

None.