SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 1352

SPONSOR: Governmental Oversight and Productivity Committee

SUBJECT: Retirement

DATE: April 27, 2000 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	Favorable/CS
2.			FP	Withdrawn
3.				
4.				
5.				

I. Summary:

The bill changes from five years to three years the time period for averaging final compensation for computation of a final pension benefit under the Florida Retirement System (FRS). It provides a uniform level of six years for vesting all classes of membership in place of the existing three vesting periods of 7, 8, and 10 years. It increases the accrual rate for active members only of the Special Risk Class for periods of service occurring between 1978 and 1993. Additionally, the bill provides special risk retirement class coverage for pilots of fixed wing aircraft, and Senior Management Service Class coverage for assistant state attorneys, assistant statewide prosecutors, and assistant public defenders. The bill also provides for the development of a retirement rate stabilization mechanism to prevent future cyclical variations in the payroll contribution rates charged member employers. The bill funds the benefit increases by an increase in the payroll contribution rates which are later offset by a recognition of 10 percent of the accrued actuarial surplus and a one-time deduction of monies from the surplus to fund repurchase of special risk upgrade time.

The bill also creates an optional defined contribution pension choice for all membership classes of the FRS. This option takes effect in 2002 and is accompanied by a 5-year graded vesting period at a 20 percent increment beginning in the second year of service and reaching 100 percent vesting at the end of six years of service. This optional choice, or portable retirement option, provides for the selection of provider companies by the State Board of Administration through a contracted third party administrator. Provider companies must meet enumerated financial, customer service, and operational criteria for themselves and their product offerings. The bill presumes all participants to be unsophisticated investors, provides all materials to be in plain language, and requires all provider fees to be equal to their most favored institutional customers.

This bill substantially amends sections 121.021, 121.0515, 121.052, 121.053, 121.055, 121.081 121.091, 121.1115, 121.1122, 121.031, and 121.121, Florida Statutes.

The bill also creates sections 121.36 and 121.571, Florida Statutes.

II. Present Situation:

The FRS is a multi-employer, non-contributory, defined benefit pension plan providing an annuitized benefit to the some 600,000 active and 175,000 retired members of its 800 public employer members. Its employee participants are grouped within seven classes or subclasses of membership with varying terms of vesting and normal service. For most members benefits are earned after the service of ten creditable years and a full, normalized retirement occurs at the sooner achievement of 30 years' service or age 62. Members of all classes are permitted to participate in a retirement deferral program for up to five additional years in exchange for a full or partial cash distribution for those periods of extra service.

The Special Risk Retirement Class encompasses some 55,000 state, county, and municipal law enforcement, firefighter, correctional officer and emergency medical technician members. It values each year of service at 3 percent, which, when multiplied times the years of service in excess of ten and the average of the best five years of compensation and accrued annual leave, yields a final pension benefit. A normalized benefit occurs at the sooner achievement of age 55 or 25 years' of service. For a number of years beginning in 1978 this percentage accrual rate was reduced to 2 percent and, when subsequently adjusted upward, was restored to its original 3 percent by 1993.

Average final compensation (AFC) is computed by law as the average of the five highest fiscal earning years, plus accrued annual leave not to exceed 500 hours, divided by 60 months. For state employees only, the maximum leave accrual is set at 480 hours.

Managerial positions are enrolled in the Senior Management Service Class which values each year of creditable service at 2 percent. Members of this class are permitted to enroll in the FRS or receive an identical state contribution to a personally owned defined contribution account in lieu of membership.

Rotor craft pilots with firefighting responsibilities are already enrolled in the Special Risk Class as the craft are engaged in the active suppression of fires at low altitudes. Fixed-wing aircraft operate at higher altitudes and provide surveillance services only.

For a number of prior sessions the Florida Legislature has considered expanding the existing defined contribution pension choices made available to higher educational faculty and senior managers to the remainder of the FRS employee base. In 1999 the Florida Senate passed CS/CS/SB 356. That bill provided an improved defined benefit as well as an alternative defined contribution plan for members of the Regular Class of the FRS.

III. Effect of Proposed Changes:

Improvement to the Defined Benefit Plan

The bill changes the period of computation of AFC from the best five to the best three years for members of the Special Risk Retirement Class of the FRS.

The bill provides for a fixed 6-year vesting period for benefit qualification across all membership classes.

The bill also retroactively reinstates a 3 percent accrual rate for all periods of special risk service between 1978 and 1993 for those members who have not yet retired.

Pilots of fixed-wing aircraft with firefighting responsibilities in the Department of Agriculture and Consumer Services are enrolled in the Special Risk Class.

The bill calls for the development of a retirement rate stabilization mechanism using the professional actuarial expertise of the State Board of Administration and the Division of Retirement.

The bill provides a series of retirement payroll cost increases to fund the vesting and average final compensation benefit increases; takes a one time reduction of $804 million in the FRS surplus to actuarially fund prior service upgrade of the active members of the Special Risk Retirement Class for periods between 1978 and 1993; recognizes 10 percent of the surplus in the FRS trust fund, and applies this surplus recognition to reduce overall retirement rates for the ensuing fiscal year.

Creation of An Optional Defined Contribution Plan

This portion of the bill incorporates provisions from the prior year Senate bill and the current year House of Representatives bill, as follows:

Vesting

Members are vested in equal 20 percent increments beginning in the second year of service and achieve 100 percent vested benefits at the completion of six years of service.

Coverage and Benefits

The bill provides a mutually exclusive plan choice to employees in all membership classes and permits them a one-time opportunity to switch back to the defined benefit plan provided they reimburse the plan for its full actuarial cost plus interest. The CS provides a fixed ten percent employer payroll costs contribution to participants in the optional retirement program and an additional increment of cost based upon their specific retirement plan for disability coverage.

Transition Provisions

Employees are permitted to transfer their accumulated and discounted account balances, in securities equivalence or cash, to the successor provider company without commission. The transfer amount will be estimated and executed on a fixed date and recalculated for determination of a precise dollar amount after 60 days.

Administrative Structure

The bill contemplates the competitive hiring of a third-party administrator and a plan educator whose roles are to provide necessary technical services for the significant financial changes prior to implementation. The plan educator will inform participants of the nature of the choices before them. The choices are designed to be informed and unconstrained but successor provider companies may provide their own educational materials. The plan administrator will be charged with selecting up to five participating companies representative of the spectrum of financial service providers in the market. The optional defined contribution program is established under the authority of the Trustees of the State Board of Administration.

Supplemental Benefits

The bill extends to defined contribution plan participants the eligibility to receive the retiree health insurance subsidy and provides a specific percentage payroll contribution for disability insurance benefits payable by the employer on behalf of each participant.

Advice and Counsel

The bill creates a Public Employee Optional Retirement Program Advisory Committee that is to assist the existing Investment Advisory Council. The committee shall recommend the critical factors to be considered in the selection of a third-party administrator and in the education component to assure its balance and impartiality.

Enrollment

Employees have 180 days to elect the optional program, after which the default is compulsory membership in the defined benefit component of the FRS.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Because the FRS is a multi-employer pension plan, the effects of this bill extend to all member FRS government employers. The bill provides an Important State Interest Clause to address the issues raised by that impact and the effect of Art. VII, s. 18, State Constitution, on local government unfunded mandates.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

The bill will require the creation of a separate trust fund for segregation of contributions from the defined benefit fund. As the operation of this part of the bill is delayed for two years it is not necessary to create this trust fund at this time.

The bill provides the necessary rate adjustments to fund the benefit increases and surplus recognition in comformity with the actuarial letters issued by the Milliman and Robertson actuarial firm commissioned and received on April 24, 2000 to effect compliance with Art. X, s. 14, State Constitution and part VII of ch. 112, F.S.

D. Other Constitutional Issues:

The bill provides the necessary rate adjustments to fund the benefit increases in compliance with the actuarial letters issued by the FRS external actuarial consulting firm to effect compliance with Art. X, s. 14, State Constitution, and Part VII of ch. 112, F.S.

The actuarial impact statements on the graded vesting component of the defined contribution plan have not yet been received but have a tentative due date of April 24, 2000.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

The bill will pass along to all employer members of the FRS an adjustment to their statutory payroll costs in order to fund the enhancement of the proposed benefit changes. The amount of this change is noted below. In all cases the change produces lower payroll costs than is currently experienced.

B. Private Sector Impact:

Membership in the Senior Management Class affords participants the opportunity to subscribe to one of several private annuity providers and share in personal ownership in a defined contribution pension plan in lieu of FRS membership. Participants making this choice will provide additional funds to their selected provider and will personally pay any fees or administrative expenses imposed through their contract.

C. Government Sector Impact:

On March 14, 2000, the FRS consulting actuarial firm of Milliman and Robertson issued a letter opinion on program changes to the benefits payable under the pension plan in response to a legislative request. The letter amended a previous report on the same subject by incorporating the results of a morbidity and mortality experience review of plan participants. Expressed as a percentage of payroll, the changes to AFC would cost an additional 1.15 percent. The employer’s retroactive repurchase of enhanced credit in that same class to all active members would cost some $804 million if deducted one time from the FRS surplus of some $9.22 billion. As a percentage of payroll, the service repurchase would be the equivalent to a 3.69 percent payroll increase for the Special Risk Class alone. The cumulative effect of the changes effected by the bill can be expressed as follows:

Cumulative Effects of Contribution Rate Changes in CS/SB 1352 on the Defined Benefit Plan Changes (FRS)	
Entering composite rate from FY 99-00	10.55
Adjustment for experience study	.36
Composite Rate, including experience	10.91
Addition for 5-year vesting	.56
Addition for 3-year AFC	.59
Less Recognition of 10% of Surplus	3.43
Adjusted Composite Rate for FY 00-01	**8.63**

In its present form the bill does not specifically address the recognition of the morbidity and mortality experience study prepared on June 30, 1998. This study suggests an additional contribution rate increase equivalent of .36 percent, or the use of some $73 million of additional FRS surplus. The Legislature is not obligated to recognize this study. A method of taking this into account is suggested below.

The transfer of the assistant state attorney, statewide prosecutor, and public defender positions to Senior Management retirement status has a fiscal impact of $1.55 million for FY 00-01. These positions already enjoy the expanded personnel benefits package approved and funded by a prior Legislature. Additional expense associated with the effect of the bill on employees of the Department of Agriculture and Consumer Services is, likewise, unbudgeted. Unless otherwise funded by a specific appropriation these amounts will have to be assumed within the payroll costs structure of the named agencies within budgeted funds. No contribution rate effect of this upgrade, other than that noted above, is presented.

By law and policy the FRS undergoes an annual valuation by outside actuaries which must be confirmed through a second, separate review. This latter requirement directs the confirmatory opinion to be issued to the legislative branch of state government. The original valuation was prepared by Milliman and Robertson and received in late 1999 for the plan year ending June 30, 1999. The second confirmatory opinion was issued February 4, 2000, by the actuarial firm of Buck Consultants to the Office of Program Policy and Governmental Accountability.

Costs associated with the development of a retirement contribution rate stabilization mechanism can be assumed within the normal actuarial expenses incurred by the Division of Retirement and the State Board of Administration.

VI. Technical Deficiencies:

None.

VII. Related Issues:

A March 14, 2000, letter from the consulting actuaries for the Florida Retirement System, Milliman and Robertson, discussed a number of other actuarial consequences of benefit changes. Contained in that report were discussions of the effects to members of the Regular Class of opting out of the FRS and purchasing their own defined contribution retirement plan with a fixed contribution rate of 10 percent.

That letter opinion also suggested that at assumed rates of investment return the use of the surplus would extend the over funding status of the FRS an additional twelve years.

Gains and losses to the FRS are amortized over a thirty year cycle. Two key assumptions used in the determination of a rate structure, other than those fixing the elements of the retirement classes themselves, are an assumed investment return of 8 percent and an overall salary increase of 6.25 percent, graded by age and years of service.

Because the FRS is noncontributory by employees, unvested members who fail to qualify for benefits at retirement have their contributions forfeited to the plan. This acts as a suppressant to higher plan costs. Contribution rates are allocated uniformly over all age groups in an actuarial method known as entry age normal.

The decision of how to recognize the experience study can be addressed in either an addition to the composite contribution rate or by recognition of a one-time deduction from the net accrued actuarial surplus. Should the latter be the chosen method, additional provision in the bill, or in the appropriations act or other implementing legislation, would be sufficient.

Higher education faculty and senior managers, already subscribers to the existing optional retirement programs, are not directly affected by this bill. There is, however, one consequence in which they will have a financial interest. These optional plans have their payroll contribution rate set, or pegged, to the normal costs rate of the regular Class of the FRS. In recent years this rate has declined and in CS/SB 1352 that rate may again decline to 8.63 percent due to the recognition of the surplus. In this sense these members will be disadvantaged by the changes in the bill unless separate action occurs to unpeg the rate linkage.

The FRS plan actuaries have estimated that most new employees will choose a defined contribution alternative at initial employment. The below table summarizes the relative benefits offered by each choice:

Comparative Features of Defined Benefit/Defined Contribution Plans Using Selected Demographic, Plan Design and Income Assurance Characteristics

	Defined Benefit	Defined Contribution
Professionals	Worse	Better
Job Changers	Worse	Better

Low wage earners	Better	Worse
Women	Better	Worse
Management	Employer	Employee
Portability	Within membership universe	Across all employers
Investment Risk	Employer	Employee
"Normal Retirement"	Fixed by statute	Variable by performance
Benefit Structure	Front loaded	Back loaded
Fees	Indirect	Direct
457 Eligibility	No difference	No difference
Vesting	Immediate/short	Delayed/lengthy
Supplemental contributions	Prohibited	Permitted
Early retirement penalty	5% per year from age 62	None
Recruitment potential	Limited	Greater

Retired employees, including those participating in the Deferred Retirement Option Program, are not affected by the bill as they are active for employment purposes but inactive for retirement purposes. Active employees who are members of closed systems, such as the Teachers' Retirement System, who did not elect to transfer to the FRS will be governed by the average final compensation provisions in existence for the plan in which they retained membership. Benefit changes apply prospectively to active and newly hired employees only.

On Wednesday, April 19, 2000, the Trustees of the Florida Retirement System, the State Board of Administration, met in an emergency meeting to develop a retirement rate stabilization mechanism. By the conclusion of that meeting the trustees had developed a broad policy which called for the enactment of a roughly 8.75 percent pension reserve to cushion the FRS from cyclical economic swings. The trustees also received testimony about an alternate method of establishing a reserve which would create a surplus yet permit the recognition of recent actuarial gains, a portion of which could be used for benefit enhancements. That alternate method is embodied in CS/SB 1352. Like the trustees' plan it recognizes a stabilization reserve of $6.185 billion. The below table summaries the methodology used in each formulation:

Presentation of Alternative Formulations of a Rate Stabilization Reserve for the Florida Retirement System ($$ in billions)

Provision	**CS/SB 1026**	**SBA Recommendation**	**CS/SB 1352**
Assets (Market)	$96.141	$104.500	$104.500
Assets (Actuarial)	$77.795	$8.415	$83.415
Liabilities (Actuarial)	$68.575	$70.685	$70.685
Actuarial Surplus	$9.220	$12.730	$12.730

Stabilization Reserve	$0	$6.185	$6.185
Benefit Enhancement	**$2.800**	**$0**	**$2.669**
Unassigned Surplus	$6.420	$6.545	$3.876
Assigned for Rate Relief	**$.642**	**$.655**	**$.775**
Net surplus	**$5.778**	**$12.075**	**$9.286**
Percent Funded	**108.4%**	**117.1%**	**113.1%**

VIII. Amendments:

None.