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.)

BILL: SB 144

SPONSOR: Senator Pruitt

SUBJECT: Florida Retirement System

DATE: November 29, 2001 REVISED: ____ ____ ____ ____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	White	O'Farrell	ED	Favorable
2.			GO	
3.			AGG	
4.			AP	
5.				
6.				

I. Summary:

Senate Bill 144 alters the benefit structure in the Regular Class of the Florida Retirement System to provide an enhanced accrual rate for teacher members of the Florida Retirement System (FRS) on a progressive, stepwise scale ranging from 1.60 percent per year for zero to 6 years of service and ending at 2.10 percent per year for 18 or more years of service.

The benefit is to be separately funded by annual recognition of a lump sum from the excess actuarial assets of the FRS Trust Fund. The amount equals 2.51 percent of the public school members’ payroll, or $212 million for 2003-2004. If necessary, the employer contribution rate will be increased to make up the difference.

This bill amends the following sections of the Florida Statutes: 121.021 and 121.091.

The bill takes effect January 1, 2003.

II. Present Situation:

The FRS is a defined benefit, nonparticipatory, multi-employer pension plan covering the employees, survivors, and dependents of some 800 State of Florida agency and local government employers. It offers a monthly benefit payable in the form of an annuity over the retiree’s lifetime that is calculated as a percentage of the member’s highest 5 years of average final pay. The FRS is composed of several sub-classes of membership with separate benefit accrual rates: Regular (1.60 percent-1.68 percent); Special Risk (3.00 percent); Special Risk, Administrative Support (1.6 percent); Senior Management (2.00 percent); Justices and Judges (3.33 percent);

and Elected Officers (3.00 percent).[1] Eligibility for normal, unreduced retirement occurs at 30 years of service or age 62, or 25 years of service and age 55 for the two special risk classes. Members must have a certain number of years of service to qualify, or vest, for benefits. Effective July 1, 2001, the vesting period is 6 years. A member may retire at any age after vesting, with an annual penalty against benefits of 5 percent per year measured from age 62. A disability retirement benefit provides pension payments for disabilities incurred both in-the line-of-duty and non-duty.

The FRS is a predominantly local government plan with state officers and employees comprising only about 25 percent of the membership. The other principal employer categories are district school boards, counties, and community colleges. Membership is compulsory for state agencies and constitutional entities; it is optional for municipalities and independent special districts, which may participate by resolution of their governing authorities. An employer may withdraw from optional membership only upon Legislative action; public hospitals are the latest employer to withdraw membership, in 1995.

Benefit administration is the responsibility of a state agency, the Division of Retirement in the Department of Management Services. Investment activities are conducted by a constitutional agency, the State Board of Administration, headed by the Governor, Comptroller, and Treasurer, and Trustees of the Florida Retirement System Trust Fund. Article X, s. 14 of the State Constitution, ch. 121,F.S., and Part VII of ch. 112, F.S., govern the operation of the system. They require that benefits must be prefunded in a sound actuarial manner.

The FRS was created in 1970 as the successor benefit plan to the separate Teachers' Retirement System, Highway Patrol retirement plan, and the State and County Officers and Employees Retirement System. The predecessor teachers' plan was approaching insolvency and its combination with the other solvent plans rescued it from financial collapse. In 1972, the FRS incorporated the last remaining independent state retirement plan, the Judicial Retirement System. Today the FRS covers about 600,000 active and 200,000 retired employees and beneficiaries. It is one of the five largest plans in the nation and reports itself as the most efficient public plan in the country in terms of administrative cost per member. Active members may choose to participate in a Deferred Retirement Option Program (DROP) during the last 5 years of their service.[2] Under its provisions, participants have their accrued monthly pension benefit paid into an account bearing a fixed interest rate of 6.5 percent. When they leave employment they may receive the account proceeds in a full or partial lump sum payment or they may transfer the accumulated account balance to another qualified retirement plan.

Retired members receive a fixed 3 percent cost-of-living allowance each July 1 on their monthly benefit and DROP account. Members who have terminated employment with vested rights, that is, the right to receive a future benefit, do not have these benefits indexed to inflation until the commencement of benefit payments. State of Florida employees have the additional option of

[1] Accrual rate is the recognized pension value per year of creditable service. For Option 1 benefits (for the life of the named retiree only) the pension value is: Accrual rate multiplied times total length of creditable service in years multiplied times average final compensation (plus up to 500 hours of annual leave). Three other reduced benefit options incorporate survivors' benefits.

[2] Participation in DROP requires the member to qualify for normal retirement and contractually commit to termination of employment within a 5-year period.

maintaining their health insurance and prescription drug coverage at retirement at full cost less a monthly health insurance subsidy payment equal to $5 per month per year of service not to exceed $150.

III. Effect of Proposed Changes:

Effect on Public School Members

The benefits of public school members will be increased based on the number of years worked after July 1, 2003, the "applicability date." The bill provides for the retroactive application of the increased formula, with 2 past years eligible for the increased rate for each year of service earned after July 1, 2003, up to a maximum retroactive applicability of 18 years. Following is an example of the effect of this bill on three members' total accrual rate:

Member	Hire Date	Retirement Date Age 62	Total Service Credit	Accrued % Value: Under Bill	Accrued % Value: Current	% Difference Under Bill
I	7/1/2003	7/1/2033	30	56.70 percent	48.00 percent	8.7 percent
II	7/1/1994	7/1/2009	15	25.80 percent	24.00 percent	1.8 percent
III	7/1/1980	7/1/2012	32	58.65 percent	52.80 percent	5.8 percent

Effect on FRS

The bill modifies the plan structure of FRS by establishing a separate subclass of public school members within the Regular Class. The retirement benefit will be higher based on a higher percentage value for each year of eligible service. As long as the FRS Trust Fund has sufficient excess of assets over liabilities, the cost of funding a retirement benefit increase may be paid from that surplus.

Section 1. Section 121.021, F.S., is amended to provide a definition of "public school member" as one who is employed by a district school system or public charter school or the Florida School for the Deaf and Blind.

Section 2. Section 121.091, F.S., is amended to provide a stepwise benefit accrual rate ranging from 1.60 percent to 2.10 percent per year for creditable service for teacher members for active service commencing after July 1, 2003, valued as follows: for 0-6 years of Regular Class Service, 1.60 percent; for 7–12 years of Regular Class Service 1.75 percent; for 13-18 years of Regular Class Service, 1.90 percent; and for over 18 years of Regular Class Service, 2.10 percent.

Section 3. This section provides for funding the costs by a recognition of excess actuarial assets of the Florida Retirement System Trust Fund. For fiscal year 2003-04, the costs are estimated to be $212 million, or 2.51% of the current public school employee payroll. If the excess is not sufficient to fully fund the costs, contribution rates for public school employees will be increased to make up the deficit.

Section 4. This section provides a declaration of important state interest in compliance with Art. VII, s. 18, State Constitution.

Section 5. The bill takes effect January 1, 2003.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Article X, s. 14, State Constitution, provides that public sector retirement plans must prefund promised benefits in a sound actuarial manner. The bill draws from an estimated additional actuarial surplus of $212 million in the FRS Trust Fund beginning in 2003.

The actuarial study performed by Milliman and Robertson, Inc. March 20, 2001, assumed that the contribution rates for employers of school board members would increase by 2.51 percent and also that the contribution for Regular Class members would increase by 2 basis points. The bill does not include the increase for Regular Class contributions. It is therefore possible that the bill's provisions are not sufficient to create the required actuarial soundness.

Prior rulings of the Florida Supreme Court have held that the Legislature may change state retirement benefits retroactively or prospectively for active employees but may not alter them once retirement benefit payments have commenced. With the 1974 enactment of a preservation of rights clause by the Florida Legislature,[3] the act of retirement became an explicitly contractual relationship which ". . . the Legislature may not abridge in any way."[4] *Florida Sheriffs* challenged the Legislature's retroactive recalculation of the special risk accrual rate and its lowering for future application. The Florida Supreme Court held that prospective changes would be within the meaning of the preservation of rights provision but that they could not be made to work retroactively to affect the vested rights members had already accrued.

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[3] Section 121.011(3)(d), F.S.

[4] *Florida Sheriffs Assoc. v. Department of Administration, Division of Retirement*, State of Florida, 408 So.2d 1033 (Fla.1981), citing *City of Jacksonville Beach, State ex. rel. Stringer v. Lee*, 147 Fla.37, 2 So.2d 127 (1941).

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Individual FRS members will receive higher pension benefits over the course of their careers. Over the a normal career length of 30 years the increase in the retirement accrual rate from 1.60 percent to 2.10 percent will raise the total multiplier from 48 percent to 56.7 percent of average final compensation. The retroactive provision permits long-service public school members to upgrade prior service to the 2.1 percent accrual rate. The provision allows two prior years to be eligible for the increased rate for each year of service after July 1, 2002. The bill does not change the duration of service required for normal service benefits, that is, 30 years.

C. Government Sector Impact:

The State Board of Administration requested the Division of Retirement in the Department of Management Services to commission an analysis of this bill by its external consulting actuary. According to the analysis provided on March 20, 2001, the contribution rates for employers of school board members need to increase by 2.51 percent and the contribution of the other members need to increase by 2 basis points to fund the increase in an actuarially sound manner. This increase represents a total fiscal impact of $212 million per year, spread over a 30 year amortization period.[5] Any contribution rate increase needed in addition the 2.51 percent authorized for employers of public school members is not specified in the bill.

VI. Technical Deficiencies:

None.

VII. Related Issues:

VIII. Amendments:

None.

[5] Chapter 2000-169, Laws of Florida, implemented an optional pension plan choice for participants in the FRS. In choosing to transfer membership to a separate defined contribution plan, members could elect to receive a liquidated account balance transfer from the defined benefit plan. Because of the actuarial method chosen for valuation of the FRS, such account balances transfers liquidate more plan liabilities than assets in the early years of employee transfer. The effect is to increase the amount of money in the FRS surplus that can be recognized for plan improvements or for an offset to expenses.