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: CS/SB 2230

SPONSOR: Governmental Oversight and Productivity Committee

SUBJECT: Florida Retirement System

DATE: March 17, 2004 REVISED:

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

I. Summary:

The bill establishes the employer payroll contribution rates for the defined benefit plan of the Florida Retirement System for the fiscal year beginning July 1, 2004.

The bill amends ss. 121.40, 121.71, and 121.74, Florida Statutes.

II. Present Situation:

The Florida Retirement System (FRS) is a multi-employer, non-participatory pension plan providing retirement income benefits to the more than 625,000 active and 210,000 retired members and beneficiaries of its more than 800 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 four 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 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 salary multiplied by the accrual rate for the membership class, plus up to 500 hours of annual leave, yield a monthly 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 of 30 years' service or age 62. For public safety employees in the Special Risk Retirement Class, normal retirement is the earlier of age 55 or 25 years' service. Members seeking early retirement 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 supplemental service. Enrollment in DROP nominally 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. All new FRS-covered employees were given the option to enroll in the new plan and existing employees were provided a once-in-a-lifetime opportunity to change their current enrollment. 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 for 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.

It has been custom since the adoption of the Investment Plan to perform annual plan valuations[1] accompanied by the setting of the contribution rates in separate legislation. The annual valuation was received on December 22, 2003, for the FRS plan year ending the prior June 30.[2] By law[3], the Legislature commissions a separate second opinion of that valuation that is performed by the Office of Program Policy Analysis and Governmental Accountability. That opinion, specifically executed by Mellon Human Resources and Investor Solutions was received some 3 weeks later.[4]

The Institute of Food and Agricultural Sciences (IFAS) at the University of Florida operates a separate supplemental pension plan for designated employees who are retired from the federal

[1] Section 121.031(3), F.S.
[2] Milliman USA, “Florida Retirement System Actuarial Valuation as of July 1, 2003.”
[3] Section 112.658, F.S.
[4] Mellon Human Resources and Investor Solutions, “Study of the 2003 Actuarial Valuation of the Florida Retirement System,” January 13, 2004.

civil service. The plan is closed to new entrants but does retain a participant census of about 200 active employees and retired beneficiaries.[5] The IFAS plan is unique in comparison to the FRS. Because it mimics the operation of Social Security, its costs as a percentage of pay increase at lower salary levels and decline as they escalate. When actual salary increases at a rate less than assumed, the benefit replacement ratio increases and subsequent valuations must raise the payroll contribution rates. In the 2003 valuation, the IFAS payroll contribution rate almost doubled due to this actuarial anomaly and concurrent unfavorable asset performance.

Since 1998 the FRS Trust Fund began to experience surpluses of assets over liabilities for the first time in its history. It has also been the recent custom to recognize a portion of this surplus as a credit toward the payroll contribution rate structure. Sections 121.031 and 121.0312, F.S., establish a method for the calculation and determination of 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 may be used to prevent wide variations 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 normalized rates are set in default.

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 and the supplemental retirement program for cooperative extension personnel at the Institute of Food and Agricultural Sciences (IFAS) at the University of Florida, as follows:

FRS Revised Contribution Rates for Fiscal Years 2004 and 2005

Retirement Class	Actual Rate, FY ’04 (%)	Normal Cost, FY ’05 (%)	Actual Rate, FY ’05 (%)
Regular	6.18	9.98	6.20
Special Risk	17.32	22.16	17.34
Special Risk, Admin.	8.71	12.55	8.73
Elected, State Const. Officers	11.28	15.82	11.30
Elected, Judges	17.44	20.78	17.46
Elected, County Off.	14.02	17.73	14.04
Senior Management	8.16	11.64	8.18
DROP	8.00	11.48	8.00

Section 2. Section 121.40, F.S., is amended to continue the IFAS rate at its current 13.83 percent of payroll until its next biennial review on June 30, 2005.

Section 3. The bill amends s. 121.74, F.S., to reduce the administrative assessment from 10 to 8 basis points (.0008) charged by the Board of Administration for the costs of administration of the

[5] N=236 as of the March 12, 2003 valuation.

portable defined contribution plan, "Investment Plan," offered to FRS employees. It also sets the effective date of the cost reduction to begin July 1, 2004.

Section 4. The bill provides a declaration of important state interest in compliance with s.18, Art. VII, State Constitution. Several hundred of the FRS employers are cities and counties subject to that amendment.

Section 5. The bill takes effect upon becoming a law.

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, Section 14, State Constitution, requires 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. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

The revised payroll contributions are electronically transmitted to each of the 837 employer members of the FRS. They apply these to the employee payroll based upon the membership class in which the person is enrolled and remit the contributions to the division which, in turn, transmits them to the System Trust Fund for investment by the Board of Administration. For comparison purposes, one basis point (.0001) equals \$100 per \$1 million of payroll.

The bill reduces an administrative assessment by 2 basis points and shifts its imposition uniformly to each of the FRS retirement classes by an equivalent amount.

The rates set in the bill are less than those recommended in the 2003 actuarial report. The difference, presumably, will be resolved through subsequent upward adjustment of the rates, a recognition of an equivalent amount of actuarial surplus, or some combination of both. The rates recommended by the consulting actuary of the FRS for the plan year beginning July 1, 2004 are: 6.57% (Regular Class); 17.60% (Special Risk Class); 8.99% (Special Risk Administrative Support Class); 17.72% (Elected Officers' Class - Judicial); 11.56% (Elected Officers' Class - State Constitutional Officers; 14.30% (Elected Officers Class - County Officers; 8.44% - Senior Management Class; and 8.15% - DROP.

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 have their operating budgets determined by the shared revenues distributed through the General Appropriations Act.

The payroll contribution rates for the Investment Plan remain fixed and do not vary with the actuarial funding requirements in the same manner as a defined benefit plan. Because a defined contribution plan assures only a contribution and not a result, there can be no unfunded liability on a contributing employer's part.

VIII. Amendments:

None.