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.)

Prepared By: Governmental Oversight and Productivity Committee

BILL: CS/SB 1152

SPONSOR: Governmental Oversight and Productivity Committee and Senator Argenziano

SUBJECT: Retirement

DATE: March 30, 2005 REVISED:

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

I. Summary:

The bill establishes the employer payroll contribution rates for the defined benefit plan of the Florida Retirement System and for the supplemental retirement plan of the Institute of Food and Agricultural Sciences at the University of Florida for the fiscal year beginning July 1, 2005.

The bill amends ss. 121.40 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 more than 625,000 active and 210,000 retired members and beneficiaries of its 840 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 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 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 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 Class, normal retirement is the earlier attainment 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 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. 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 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.

It has been the 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 in December 2004 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

[1] Section 121.031(3), F.S.
[2] Milliman USA, "Florida Retirement System Actuarial Valuation as of July 1, 2004."
[3] Section 112.658, F.S.

(OPPAGA). That opinion, specifically executed by Gabriel, Roeder, Smith and Company was received in early March 2005.[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 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 salaries increase. 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. The ending actuarial surplus for the current valuation year is approximately $11.5 billion. It has 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 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.

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 compensation between entry age and assumed exit.

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. 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 FY 2006 recommended budget is based. Normal cost rates do not recognize any surplus amounts.

[4] Gabriel, Roeder, Smith & Company, "Actuarial Review of the July 1, 2004 Actuarial Valuation of the Florida Retirement System," March 8, 2005, in OPPAGA, "Florida Retirement System Pension Plan Fully Funded and Valuation Met Standards," Report 05-00, March 2005.

[5] N=198 as reported in of the 2003 annual report of the Division of Retirement.

FRS Actual and Proposed Contribution Rates for Fiscal Years 2005 and 2006

Retirement Class	CS/SB 1152	Governor's FY '06 (%) Budget	2004 Valuation Normal Cost, FY '06 (%)	Actual Rate in Effect, FY '05 (%)
Regular	**6.20**	**7.31**	9.53	**6.20**
Special Risk	**17.34**	**18.45**	21.91	**17.34**
Special Risk, Admin.	**8.73**	**9.84**	12.39	**8.73**
Elected State Officers	**11.30**	**12.43**	14.86	**11.30**
Elected, Judges	**17.46**	**18.53**	20.43	**17.46**
Elected, County Off.	**14.04**	**15.10**	17.00	**14.04**
Senior Management	**8.18**	**9.29**	13.27	**8.18**
DROP	**8.00**	**8.00**	11.74	**8.00**

Section 2. Section 121.40, F.S., is amended to raise the IFAS rate from 13.83% to 20.23% for the biennium beginning July 1, 2005.

Section 3. The bill provides a declaration of important state interest in compliance with s. 18, Art. VII, State Constitution.

Section 4. 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.

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 840 employer members of the FRS. The employers apply these enacted rates 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 rates set in the bill differ from those recommended in the 2004 actuarial report. The difference is resolved through subsequent upward adjustment of the rates, a recognition of an equivalent amount of actuarial surplus, or some combination of both as part of the annual state budget and appropriations process.

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.

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 an employer contribution and not an investment result, there can be no unfunded liability on a contributing employer’s part.

The SBA has prepared a set of alternative payroll contribution rates that make use of what it considers an appropriate level of surplus recognition. These rates also reallocate the cost of DROP to lessen reliance on a disproportionate use of actuarial surplus to subsidize that rate.

State Board of Administration,
FRS Alternative Contribution Rates (%), FY 2006

Fiscal Year	Regular	Special Risk	Special Risk, Adm.	Judicial	Elected State	Elected County	Senior Mgmt.	DROP
2006[6]	**7.43**	**17.08**	**9.66**	**15.93**	**11.59**	**13.26**	**10.35**	**8.89**
2006[7]	**8.04**	**17.70**	**10.27**	**16.54**	**12.20**	**13.87**	**10.96**	**9.71**

In a separate communication, the SBA provided affected parties with observations on what it believed the proper recognition of long-term pension costs should be relative to the use of sums from the accrued actuarial surplus. The SBA cautions against sustained recognition of non-recurring sums outside of the Rate Stabilization Mechanism formula and bases its recommended rate structure on the use of the nominal statutory formula for surplus as modified by experience and good actuarial practice. In a document appended to this February 8, 2005 communication directed to leadership in the Executive and Legislative Branches, the SBA staff identified what it believed to be six important factors in the allocation of pension plan costs to minimize the distortion of long-term costs relative to short-term funding considerations.

[6] Normal cost using available surplus as defined by nominal statutory formula.
[7] Same as above with weighted reallocation of costs based upon Investment Plan experience.

VIII. Summary of Amendments:

None.