

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: Ways and Means Committee

BILL: HB 1907

SPONSOR: House Fiscal Responsibility Council

SUBJECT: FRS/Payroll Contribution Rates

DATE: April 20, 2005

REVISED: 4/22/05

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McVaney	Coburn	WM	Fav/1 amendment
2.				
3.				
4.				
5.				
6.				

Please see last section for Summary of Amendments

Technical amendments were recommended

Amendments were recommended

Significant amendments were recommended

I. Summary:

The bill establishes the employer payroll contribution rates for the Florida Retirement System for the fiscal year beginning July 1, 2005.

The bill amends s. 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 State 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 the Justices and Judges subclass. 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 Employee 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 a member an equity interest in the employer’s payroll contributions and the associated 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.

It has been the custom since the adoption of the Investment Plan to perform annual plan valuations¹ 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

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 shows the contribution rates effective July 1, 2004, and July 1, 2005, for each class or subclass as established by the 2004 Legislature as well as the normal cost of the Florida Retirement System as determined by the state actuary, effective July 1, 2004.

<u>Class</u>	<u>Current 07-01-04 Rates</u>	<u>Current 07-01-05 Rates</u>	<u>Normal Cost 07-01-04</u>
Regular Class	6.20%	9.98%	9.53%
Special Risk Class	17.34%	22.16%	21.91%
Special Risk Admin. Support Class	8.73%	12.55%	12.39%
Elected Officers' Class – Judicial Subclass	17.46%	20.78%	20.43%
Elected Officers' Class – Leg.-Atty.-Cab. Sub	11.30%	15.82%	14.86%
Elected Officers' Class – County	14.04%	17.73%	17.00%
Senior Management Service Class	8.18%	11.64%	13.27%
Deferred Retirement Option Program (DROP)	8.00%	11.56%	11.74%

These contributions are paid into the Florida Retirement System Contributions Clearing Trust Fund. Amounts necessary to pay the benefits due under the defined contribution program are transferred into the participants' accounts (for retirement benefits) and into the disability account of the Florida Retirement System Trust Fund (for disability benefits). The remainder of these contributions is transferred to the Florida Retirement System Trust Fund to pay for the benefits due under the defined benefit program.

Based on the 2004 Actuarial Valuation of the Florida Retirement System, the System has an actuarial surplus of \$11.5 billion as of June 30, 2004. Actuarial liabilities increased by \$5.9 billion during between July 1, 2003, and July 1, 2004, while the actuarial value increased only \$4.8 billion during the same period.

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; and salary

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.

growth of 4.00 percent (inclusive of 3.00 percent inflation). Benefit payments further assume 139 hours of annual leave used to enhance or “spike” the final benefit.

In addition to the contribution rates paid by employers for retirement and disability benefits, s. 121.74, F.S., imposes an assessment of 0.08% of payroll to cover the administrative and educational expenses incurred by the State Board of Administration. This assessment generates approximately \$17.8 million in FY 2004-05 to offset \$17.1 million of anticipated expenses for the year.

Within the first 30 days of retirement, all FRS covered employees are provided the enrollment opportunity 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. This subsidy is funded by a 1.11% assessment against each employer’s active payroll.

III. Effect of Proposed Changes:

Section 1 amends s. 121.71, F.S., to set the employer payroll contribution rates for the Florida Retirement System as follows:

Retirement Class	Current Statutory Rate for FY 2004-2005	Current Statutory Rate for FY 2005-2006	Proposed Rate for FY 2005-2006	Proposed Rate for FY 2006-2007 (2003 Normal Cost)
Regular	6.20%	9.98%	6.20%	9.98%
Special Risk	17.34%	22.16%	17.34%	22.16%
Special Risk, Admin.	8.73%	12.55%	8.73%	12.55%
Elected State Officers	11.30%	15.82%	11.30%	15.82%
Elected, Judges	17.46%	20.78%	17.46%	20.78%
Elected, County Off.	14.04%	17.73%	14.04%	17.73%
Senior Management	8.18%	11.64%	8.18%	11.64%
DROP	8.00%	11.56%	8.00%	11.56%

Section 2 provides that 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, 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:

With the enactment of this legislation, the revenues expected to flow into the Florida Retirement System in FY 2005-2006 will be reduced by approximately \$850 million. The total amount of surplus that will be used to offset such costs is approximately \$850 million.

Comparing the contribution rates established by this bill to the 2004 normal costs determined by the state actuary, employers participating in the FRS will enjoy a reduction in retirement costs for FY 2005-2006. The reductions by employer group are noted below:

State agencies	\$159.9 m
State Universities	31.5 m
Community Colleges	23.3 m
School Boards	358.8 m
Counties	240.7 m
Other	<u>37.6 m</u>
TOTAL	\$851.8 m

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 employers participating in 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
2006⁵	7.43	17.08	9.66	15.93	11.59	13.26	10.35	9.15
2006⁶	8.04	17.70	10.27	16.54	12.20	13.87	10.96	9.15

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.

⁵ Normal cost using available surplus as defined by nominal statutory formula.

⁶ Same as above with weighted reallocation of costs based upon Investment Plan experience.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

VIII. Summary of Amendments:

Barcode 725822: Ways and Means Committee

The amendment continues the current retirement rates for another year but adjusts the July 1, 2006, rates to the 2004 normal cost level. The amendment also sets the contribution level for the IFAS retirement plan. Lastly, the amendment reduces the State Board of Administration's administrative and educational fee from 8 basis points to 5 basis points.

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