

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: SB 302

SPONSOR: Senator Atwater

SUBJECT: FRS/Purchase of Retirement Credit

DATE: April 22, 2005

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Wilson</u>	<u>Wilson</u>	<u>GO</u>	<u>Pre-meeting</u>
2.	_____	_____	<u>GA</u>	_____
3.	_____	_____	<u>WM</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill permits participants with vested rights in the Florida Retirement System to purchase up to five years of service credit otherwise not creditable under any other provisions recognized as equivalent prior public service.

This bill creates section 121.11225, 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 633,000 active and 226,000 retired members and beneficiaries of its 840 state and local government 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, yields a monthly benefit at normal retirement. The accrual rates range from 1.60-1.68 percent for the Regular Class to 3.33 percent for Justices and Judges. For most membership classes normal

retirement occurs at the earlier of thirty 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 twenty-five years' service. Members seeking early retirement receive a five percent reduction in the benefit for each year below their normal retirement age threshold. All Pension Plan 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 requires the participant to serve the employer with a deferred resignation from employment at the end of the period. The Pension Plan includes a fixed, annual cost-of-living adjustment of three percent for retirees.

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 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.

All state employees are provided with the enrollment opportunity within the first thirty 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, s. 112.363, F.S., is a five dollar 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.

The Special Risk Retirement Class is principally composed of law enforcement, correctional and correctional probation personnel. In recent years this class has been augmented through the addition of emergency medical personnel and various state correctional system employees whose work requires them to spend their official duties within the security perimeter of a state correctional or forensic facility. Elected officials with law enforcement responsibilities have the option of choosing membership in the Elected Officers' Class or the Special Risk Class.

Various provisions of the FRS chapter permit the purchase of prior service from other public employment as a credit toward normal retirement. Participants with wartime service in the military may purchase this service under more favorable terms. While several retirement classes permit employer participation in the purchase of prior service the presumption is that its payment must come from the personal funds of the participant. All prior service is presumed to occur at the beginning of the career and is creditable in the Regular Class only.

III. Effect of Proposed Changes:

The bill creates s. 121.112255, F.S., to permit participants in the FRS with vested rights and who have been continuously employed for at least one year to purchase up to five years' additional service credit not otherwise creditable under other purchase-of-service provisions.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

The FRS is a multi-employer plan and a large portion of its participants work for cities and counties. The bill, however, does not contain a declaration of important state interest. As discussed, below, the additional fiscal impact of this bill on the participating public employers constitutes an unfunded mandate as defined in s. 18, Art. VII, State Constitution.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Section 14 of Article X, State Constitution, requires the prefunding of public sector pension plans in a sound actuarial manner. There is an additional cost to the public employers for the additional purchase requirement that is not specifically funded in the bill. Absent this funding, the bill in its present form violates this constitutional provision.

V. Economic Impact and Fiscal Note:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

Participants availing themselves of this provision may find themselves serving a shorter career prior to receiving normal benefits. Alternatively, they may serve the same career length and receive higher benefits.

C. Government Sector Impact:

On April 19, 2005, the Division of Retirement transmitted a financial analysis of this bill completed by its consulting external actuary. The actuary made a number of assumptions about the demographic and salary composition of the eligible population taking advantage of this bill's provisions. Two analyses were completed, one estimating ten

percent of the population purchasing three years' service and the other assuming one hundred percent of the population purchasing the full five years' service. The estimated employer portion of the cost is reported below:

**Estimated Employer Costs for Employee Purchase of Non-Qualified Service Credit
Senate Bill 302, Assuming 10%/3 years and 100%/5 Years of Eligible Members,
Payroll Contribution Rate and Costs for All Retirement Classes**

Employer Costs	10% / 3 Years	100% / 5 Years
Additional Rate (Composite)	.18%	3.36%
Unfunded Liability, Single, Lump Sum Amortization	\$328,018,000	\$5,760,620,000
Additional Dollars, First Year Only	\$ 44,947,000	\$ 833,942,000

The above estimates do not include the additional costs paid by the participant who purchases this service credit. These amounts vary with the distance from the time of first service. Generally, a person seeking to purchase one year of service at least twenty-five years removed from the initial point of hire will have to pay about \$20,000 in personal funds. This amount includes the 6.5 percent in retroactive compound interest on the employer contribution for those accumulated years. The closer the repurchase to the point of vesting the less expensive it becomes.

VI. Technical Deficiencies:

As noted, above, the bill fails to include a funding provision for the benefit increase or a statement of important state interest.

VII. Related Issues:

Other states and large private employers permit the purchase of service credit in their sponsored pension plans. Florida law requires service credit to be evidenced by *actual* work with an employer with a comparable benefit plan. SB 302 does not define non-qualified service credit, or "air time" as it is more popularly known, and there is no requirement that the participant ever have worked to claim it.

Some public employers use such devices as an inducement for recruitment and retention, others as a compensating mechanism for headcount reduction during reductions in force. About one-half of FRS participants work for educational units, a large number of whom occupy instructional positions in district school boards. These employers are directly affected by the classroom ratio provisions of Art. IX, s. 1 of the State Constitution. As a recruitment mechanism this bill could attenuate problems in the districts school boards affected by the ratios; as a departure mechanism, the bill could accelerate the depletion of instructional and other personnel directly impacted by the ratio provision.

Many other public employers configure their workforces on the basis of specific ratios. Law enforcement and correctional organizations use a post chart device to generate the number of positions required per surveillance unit. Social service and hospital organizations have similar staffing models, implemented in part by the effects of litigation settlements or other policy considerations.

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:

None.

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