HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 563 Florida Retirement System
SPONSOR(S): Pickens and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 1266

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Governmental Operations Committee		Brazzell	Everhart
2) PreK-12 Committee			
3) Fiscal Council			
4) State Administration Council			
5)			

SUMMARY ANALYSIS

HB 563 provides for a system of increased retirement benefits for certain “public school members”, as defined by the bill, in the Regular Class of the Florida Retirement System. These benefits are determined based on a formula which considers the individual’s total years of service, years of service worked before a certain date, and years of service worked after that date. The bill gradually increases the accrual rates earned the longer an individual works. During a phase-in period of 9 years, individuals with prior service will have their accrual rates retroactively increased under certain conditions.

This bill funds the benefit increase through either the use of actuarial surplus in the Retirement System Trust Fund, increases in Regular Class employer contribution rates, or a combination of both.

An actuarial study for a similar bill was performed in 2001; however, due to significant changes made to the Florida Retirement System, that study is outdated and not valid for this bill. **Thus this bill does not meet the Constitutional provisions requiring an actuarial study for legislation impacting public pension benefits.** *See “Constitutional Issues”, below.*

The fiscal impact on state and local governments is unknown. A previous study, now outdated, indicated first year costs of approximately $212 million. *See “Fiscal Comments”, below.*

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

This bill does not appear to implicate any of the House Principles.

B. EFFECT OF PROPOSED CHANGES:

Present situation

The Florida Retirement System (FRS) provides retirement and disability benefits for Florida state and county employees and for employees of those cities and special districts which choose to participate in the FRS. As of June 30, 2004, state employees (including university employees) represent 21.83% of the FRS membership; counties, 23.46%; district school boards, 48.3%; and community colleges, 2.84%; and cities and special districts that have opted to join the FRS, 3.57%.

The active membership of the FRS is divided into five membership classes. Each class is separately funded based upon the costs attributable to the members of that class. The classes and their current employer contribution rates as a percent of gross compensation are:

- Regular Class, 6.20%.
- Special Risk Class, 17.34%.
- Special Risk Administrative Support Class, 8.73%.
- Elected Officers' Class, 11.30%-17.46%, depending on subclass.
- Senior Management Service Class, 8.18%.

The vast majority of FRS members, including most employees of school boards, are in the Regular Class. Regular Class members accrue benefits at a rate of 1.60% per year, meaning that provided the member vests in the system, for each year worked, upon retirement the Regular Class member's initial benefit is 1.60% of his or her average final compensation per year worked. However, a number of factors determine a member's benefit, such as the age he or she retires, whether he or she receives disability retirement, or whether he or she works beyond the normal retirement date.

Since 1976, the Florida Constitution has required that benefit improvements under public pension plans in the State of Florida must be concurrently funded on a sound actuarial basis. This provision has led the Florida Retirement System to be one the soundest public pension plans in the nation. The Retirement System Trust Fund currently has excess actuarial assets. "Excess actuarial assets", also known as the "actuarial surplus" or "surplus assets", are assets that actuarial studies project are not currently projected to be needed to pay for future liabilities.

Section 121.031, F.S., governs the use of these surplus assets. Subsection (2)(f) provides that "it is the intent of the Legislature to maintain as a reserve a specific portion of any actuarial surplus, and to use such reserve for the purpose of offsetting future unfunded liabilities caused by increases in contribution rates." However, s.121.031, F.S., provides that, depending on the amount of such assets, another portion of the surplus may be used to offset total retirement system costs, lowering the contribution rates paid by FRS employers below what they would otherwise pay. This section limits the amount of the surplus that may be used to offset system costs. The law also requires that unfunded actuarial liabilities for the current year be paid with any surplus.

Proposed changes

Public school members—defined as members of the Florida Retirement System Regular Class employed by a district school system, public charter school, or the Florida School for the Deaf and Blind—would potentially enjoy enhanced retirement benefits.

Benefit accrual rates would vary depending upon length of service, escalating from 1.6% for the first 6 years of service to 2.1% for service beyond 18 years. The higher credit would be applied prospectively, but would have retroactive application for those who are in covered employment between July 1, 2006, and June 30, 2015. For each year of eligible service in this period, the member would receive 2 years of retroactive coverage (up to a maximum of 18 years of retroactive coverage). The impact of this benefit varies. A member who retires in 2008 with 30 years of service will have an average annual accrual rate of 1.6% and thus receive no increased benefit. A member who retires in 2018 with 30 years of service will have an average annual accrual rate of 1.89%; if this person had $35,000 average final compensation, he or she would have a monthly benefit increase of $254.

Public school members comprise nearly half of the current membership of the Regular Class. There are approximately 306,000 employees of school boards, public charter schools, and the Florida School for the Deaf and Blind who are in the Regular Class.[1] Nearly 291,000 are in the defined benefit plan.

The bill seeks to fund these benefits first by using surplus assets in the Retirement System Trust Fund. If these assets are not sufficient or are unavailable, the Regular Service Class contribution rate would then be increased for all employers of Regular Service Class members as necessary to fund the benefit.

Funding of this benefit with surplus assets would exhaust those assets more quickly with the result that employer contribution rates for all classes, not just the Regular Class employers or public school member employers, would need to increase at an earlier date or a faster rate than would otherwise be the case.

If Regular Class employer contribution rates were increased, all Regular Class employers would be subject to the increase, not just employers of members who would receive these benefits.

C. SECTION DIRECTORY:

Section 1 amends s. 121.021, F.S., to provide a definition for the term “public school member.”

Section 2 amends s. 121.091, F.S., to provide for revised accrual rates for public school members.

Section 3 provides for funding of this benefit.

Section 4 provides a declaration of important state interest.

Section 5 provides an effective date of July 1, 2006.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   Indeterminate. No actuarial study has been performed for this bill, so the projected costs are unknown. See “Fiscal Comments” below.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

[1] HB 563 Bill Analysis, Department of Management Services.

1. Revenues:

   None.

2. Expenditures:

   Indeterminate. No actuarial study has been performed for this bill, so the projected costs are unknown. See "Fiscal Comments" below.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

An actuarial study for a similar bill was performed in 2001; that study determined that the first-year costs of that bill were $212 million. However, due to significant changes made to the Florida Retirement System (FRS), that study is outdated and not valid for this bill. Thus the reference in the bill to an annual cost of $212 million (line 148) is incorrect.

The bill seeks to fund the benefits it provides first by using surplus assets in the Retirement System Trust Fund. If these assets are not sufficient or are unavailable, the Regular Service Class contribution rate would then be increased for all employers of Regular Service Class members as necessary to fund the benefit. Funding of this benefit with surplus assets would exhaust those assets more quickly with the result that employer contribution rates for all classes, not just the Regular Class employers or public school member employers, would need to increase at an earlier date or higher rate than would otherwise be the case. These higher rates would be borne not just by state government but by counties, school districts, and those municipalities and special districts that have opted into the FRS.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   While this bill does not provide benefits to employees of counties or those municipalities that have opted into the Florida Retirement System, by increasing benefits for other employees of other FRS Regular Class employers, the bill will require counties and certain municipalities to expend funds through higher employer contribution rates and is thus a mandate. This bill does not contain any provisions that would exempt it from the requirements of Art. VII, s. 18(a). However, the bill contains a statement of important state interest and does apply to all persons similarly situated and thus meets the requirements of Art. VII, s. 18(a) to bind effectively counties and municipalities.

2. Other:

   <u>Article X, s. 14, Florida Constitution</u>

   Since 1976, the Florida Constitution has required that benefit improvements under public pension plans in the State of Florida must be concurrently funded on a sound actuarial basis, as set forth below:

   SECTION 14. State retirement systems benefit changes.--A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not after January 1, 1977, provide any increase in the benefits to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis.

Part VII of Chapter 112, F.S.

Article X, s. 14 of the Florida Constitution is implemented by statute under part VII of chapter 112, F.S., the "Florida Protection of Public Employee Retirement Benefits Act," which establishes minimum standards for the operation and funding of public employee retirement systems and plans in the State of Florida. The key provision of this act states the legislative intent to "prohibit the use of any procedure, methodology, or assumptions the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers."

An actuarial study for a similar bill was performed in 2001; however, due to significant changes made to the Florida Retirement System[2], that study is outdated and not valid for this bill. Thus this bill does not comply with Article X, s. 14 of the Florida Constitution and Part VII of Chapter 112, F.S.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

In lines 68-72, the term "applicability date" appears to be simultaneously intended to refer to a specific date—July 1, 2006—but also to various other dates that change as a member's years of service increase. If the intent is to have various dates be used in calculating a member's benefit, revisions could improve the clarity of this section.

The system of benefits this bill provides is very complicated. It may be difficult for public school members to determine the benefits they are due. It may be possible to achieve the bill's goals in a simpler fashion.

It appears that for a public school member who has 30 or more years of service, between July 1, 2006, and July 1, 2012, he or she would not receive the increased accrual rates to which the individual would otherwise be entitled. That is because the bill provides that service earned for the first six years after the July 1, 2006, date is only accrued at a rate of 1.60%.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

Not applicable.

[2] Such changes include the reduction of vesting requirements from 10 years to 6 years and the discontinuation of the option for members to transfer to the defined contribution plan.