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 1040

INTRODUCER: Governmental Oversight and Productivity Committee and Governmental Oversight and Productivity Committee

SUBJECT: Retirement

DATE: March 22, 2006 REVISED:

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

I. Summary:

Section 121.031, F.S., provides for an annual actuarial study of the Florida Retirement System and for a report of the results to the Legislature by December 31 each year. Thereafter, the Legislature establishes uniform contribution rates in law annually. Participating employers in the Florida Retirement System must make monthly contributions to fund the system.

The bill establishes the required employer payroll contribution rates for each membership class and subclass of the defined benefit plan of the Florida Retirement System retirement plan for the fiscal year beginning July 1, 2006.

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 more than 850 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 and Special Risk Administrative Support Classes, 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. 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.

Section 121.031(3), F.S., provides that the administrator[1] shall perform an actuarial study of the system at least annually and must report the results to the Legislature by December 31 each year. The annual valuation was received in December 2005 for the FRS plan year ending the prior

[1] Section 121.025, F.S., designates the secretary of the Department of Management Services as the administrator of the retirement and pension systems.

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 (OPPAGA). That opinion, specifically executed by Gabriel, Roeder, Smith and Company was received by OPPAGA March 3, 2006.[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 $9 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. While the rate stabilization mechanism is instructive for the setting of rates, the Legislature is under no obligation to adhere to it and has for the past few years used amounts in excess of the formula to subsidize the normal cost structure of FRS.

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. 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 2006-2007 recommended budget is based. Normal cost rates do not recognize any surplus amounts.

[2] Milliman USA, "Florida Retirement System Actuarial Valuation as of July 1, 2005."
[3] Section 112.658, F.S.
[4] Gabriel, Roeder, Smith & Company, "Actuarial Review of the July 1, 2005 Actuarial Valuation of the Florida Retirement System," received by OPPAGA March 3, 2005. As of this date, the OPPAGA report has not been finalized.

FRS Actual and Proposed Contribution Rates
For Fiscal Years 2006 and 2007

Retirement Class	PCS/SB 1040 FY 06-07 (%)	Normal Cost Rates FY 06-07 Based on 2005 Valuation	Actual Rate in Effect FY 05-06 (%)
Regular	8.69	9.55	6.67
Special Risk	19.76	21.96	17.37
Special Risk, Admin.	11.39	12.65	8.76
Elected State Officers	13.32	14.80	11.33
Elected, Judges	18.40	20.44	17.49
Elected, County Off.	15.37	17.08	14.07
Senior Management	11.96	13.29	9.29
DROP	9.80	10.89	8.22

Section 2. The bill provides a declaration of important state interest in compliance with s. 18, Art. VII, State Constitution.

Section 3. 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. As is discussed, below, the changes contemplated in this year's rate bill impact this constitutional requirement.

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 2006-2007 will be reduced by approximately $285.6 million. The total amount of the surplus that will be used to offset such costs is approximately $285.6 million.

Comparing contribution rates established by this bill to the 2005 normal costs determined by the state actuary, employers participating in the FRS will experience a reduction in retirement costs for FY 2006-2007. The reductions by employer group are noted below:

State Agencies	$ 57.5 million
State Universities	9.3 million
Community Colleges	7.0 million
School Boards	105.2 million
Counties	93.9 million
Other	12.6 million
TOTAL	$285.6 million

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 SBA. 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 2005 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 appropriation process.

VI. Technical Deficiencies:

None.

VII. Related Issues:

This committee substitute 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.

By letter dated March 20, 2006, the SBA has reviewed the Florida Retirement System Actuarial Valuation report dated December 2005, as provided in s. 121.0312, F.S.[5] This letter notes that the valuation includes in supplemental material actuarially required rates that incorporate a cost component or "blended rate" for the FRS defined contribution plan. The SBA recommends this set of blended rates.

State Board of Administration,
FRS Blended Contribution Rates (%), FY 2006-2007

Fiscal Year	Regular	Special Risk	Special Risk, Adm.	Judicial	Elected State	Elected County	Senior Mgmt.	DROP
2007	**8.42**	**20.76**	**11.43**	**19.26**	**13.65**	**15.93**	**11.90**	**10.89**

In the SBA letter, it noted that these rates (which aggregate to 10.30% for the system as a whole, including DROP), are 109 basis points below FRS's recurring cost of 11.39% (the so-called "normal" rate).

[5] This section provides that "[t]he Governor, Chief Financial Officer, and Attorney General, sitting as the Board of Trustees of the State Board of Administration, shall review the actuarial valuation report prepared in accordance with the provisions of this chapter. The board shall review the process by which Florida Retirement System contribution rates are determined and recommend and submit any comments regarding the process to the Legislature."

VIII. Summary of Amendments:

None.