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 1042

INTRODUCER: Governmental Oversight and Productivity Committee

SUBJECT: Florida Retirement System; Institute of Food and Agricultural Sciences Supplemental Retirement Program

DATE: January 12, 2006 REVISED: 01/25/06

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

I. Summary:

This bill implements a recommendation from an approved Interim Project Report[1] that called for the merger of the separately constituted supplemental retirement program for designated employees at the University of Florida's Institute of Food and Agricultural Sciences into the Florida Retirement System.

This bill creates s. 121.047, F.S., and substantially amends s. 121.40, F.S.

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 866 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 Title 26 of the United States Internal Revenue Code, its benefits are exempt from federal taxation until received by the employee.

[1] Florida Senate, *The Supplemental Retirement Program of the Institute of Food and Agricultural Sciences at the University of Florida*, Report No. 2006-132, September 2005.

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 or service threshold.

All membership classes permit enrollment in a Deferred Retirement Option Program (DROP) under which a participant retires but extends employment for an additional five years - eight years for instructional personnel[2] 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.

[2] The extended participation limits apply only to those categories specifically referenced in s. 1012.01(2) (a)-(e), F.S.: classroom teachers; student personnel services; librarians/media specialists; other instructional staff; and education paraprofessionals. Extended participation is permitted at the discretion of the employing authority.

It has been the custom since the adoption of the Investment Plan to perform annual plan valuations[3] 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.[4] By law,[5] 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 in early March 2005.[6]

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 was estimated to be approximately $9.6 billion on September 28, 2005. 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 Rate Stabilization Mechanism (RSM) 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 RSM is instructive to the legislative branch in the setting of a final payroll contribution rate but is not determinative of a final result. 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. The assumptions are derived from the proceedings of the Florida Retirement System Actuarial Assumption Estimating Conference established in s. 216.136(10), F.S. Benefit payments further assume a residual 139 hours of annual leave used to enhance or “spike” the final benefit.

The actuarial valuation method used for the FRS 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.

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.[7] 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

[3] Section 121.031(3), F.S.
[4] Milliman USA, “Florida Retirement System Actuarial Valuation as of July 1, 2004.”
[5] Section 112.658, F.S.
[6] 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.
[7] N=193 as reported in of the 2004 Annual Report of the Division of Retirement.

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. Because the IFAS plan is closed to new members and is structured in such a fashion as to provide a conservative investment approach to its assets, the payroll contributions and investment earnings are insufficient to satisfy payment obligations to beneficiaries and dependents. The 2005 Legislature ameliorated this negative cash flow situation by providing an additional $500,000 appropriation to IFAS. Since only active participants receive an employer contribution, the progressively declining census will condition a permanent negative cash flow requiring one of three periodic actions: plan closure and merger with FRS; annual subsidies from the state treasury; or substantial payroll contribution increases by IFAS itself that will be several multiples in excess of equivalent FRS levels.

III. Effect of Proposed Changes:

The bill implements a recommendation of a Senate committee interim project, as follows:

Section 1. Section 121.047, F.S., is created to consolidate the assets and liabilities of the IFAS supplemental retirement program within the system trust fund of the FRS effective July 1, 2006, but continues the IFS structure a separate entity distinguishable from the FRS.

Section 2. Section 121.40, F.S., is amended to delete specific reference to the IFAS supplemental pension plan and to substitute future reference to the FRS. The section also amends the biennial employer payroll contribution rate effective July 1, 2006 to reflect future funding requirements. Because the FRS System trust Fund will assume the assets and liabilities, separate references to an immunized investment strategy and biennial IFAS plan actuarial valuations are repealed.

Section 3. The bill provides a statement of important state interest in compliance with s. 18 of Art. VII, State Constitution and to effect the full actuarial funding requirements of s. 14 of Art. 10, State Constitution for public sector pension plans.

Section 4. Provides an effective date.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

Implementation of this bill will no longer necessitate the appropriation of $500,000 or more annually to subsidize the insufficient payroll revenues flowing into the IFAS plan. The employer will also pay reduced payroll contributions. Effective July 1, 2006, the contributions will be reduced from the current 20.23 percent of covered payroll to 14.23 percent.

The Division of Retirement advises that there will be a slight additional cost to the FRS System Trust Fund after the consolidation but the effect will not result in any change to the payroll contribution rate charged all other plan members. The additional liability is about $20 million.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.