The Florida Senate

PROFESSIONAL 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: General Government Appropriations Committee

BILL: CS/SB 1488

INTRODUCER: Governmental Operations Committee

SUBJECT: The Florida Retirement System

DATE: April 13, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	**Fav/CS**
2.	Pigott/McVaney	DeLoach	GA	**Favorable**
3.				
4.				
5.				
6.				

I. Summary:

This bill implements a recommendation from two separate Interim Project Reports[1] that recommended the merger of the separately constituted supplemental retirement program for designated employees at the University of Florida's Institute of Food and Agricultural Sciences (IFAS) into the Florida Retirement System.

This bill creates section 121.047, Florida Statutes.

This bill substantially amends section 121.40, Florida Statutes.

II. Present Situation:

Supplemental Retirement Act for the Institute of Food and Agricultural Sciences

In 1984, the Florida Legislature created a supplemental retirement plan for cooperative extension service employees at the University of Florida's Institute of Food and Agricultural Sciences (IFAS). The effective date of the Supplemental Retirement Program was July 1, 1985. Employees hired on or before July 1, 1983, were eligible for the program if they held both state and federal appointments while employed at the Institute, were not entitled to any benefit from a state-supported retirement system or Social Security based on their service as an Institute employee, and were participants in the Federal Civil Service Retirement System. In establishing the supplemental plan, the Legislature intended to equalize benefits received by IFAS and FRS

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[1] Florida Senate, *The Supplemental Retirement Program of the Institute of Food and Agricultural Sciences at the University of Florida*, Report No. 2007-127, October 2006; Report No. 2006-132, September 2005.

members (including social security). Upon retirement from the Institute, qualifying IFAS employees would receive a supplemental benefit equal to the difference between their federal benefit and an FRS benefit for equivalent service, plus social security.

Like the FRS Pension Plan, the IFAS plan is a defined benefit plan. For service after December 1, 1970, retirement credit accrues under IFAS at the rate of 1.6% of the participant's average monthly compensation in his/her highest 5 years of credited service — essentially the same as the accrual rate for members of the Regular Class of the FRS. And, like the FRS, which has been employee-noncontributory since 1975, the IFAS plan is funded solely through employer contributions made for active participants, together with investment earnings. Because any Institute employees hired after July 1, 1983, qualify for FRS and social security benefits, they are ineligible to receive the supplement. Therefore, the IFAS supplemental plan is effectively a "closed system." With a fixed population, the ranks of active participants shrink over time. Unlike the FRS, which has about three active employees for every annuitant, the 190 remaining IFAS plan participants include 81 active participants and 109 annuitants. As the ratio of annuitants to active participants increases, there is an ever-greater demand for contributions and investment earnings to generate funding sufficient to provide the promised benefits, coupled with an ever-diminishing stream of payroll on which contributions are based. This has led to an unsustainable funding situation.

IFAS investment restrictions

Complicating IFAS plan funding problems, paragraph (13)(a) of s. 121.40, F.S., requires that IFAS plan funds be invested only in the most conservative, lowest-risk securities:

> 121.40 Cooperative extension personnel at the Institute of Food and Agricultural Sciences; supplemental retirement benefits.—
>
> (13) INVESTMENT OF THE TRUST FUND.—
> (a) The State Board of Administration shall invest and reinvest available funds of the trust fund in accordance with the provisions of ss. 215.44-215.53. *The board shall consider investment techniques,* such as contingent immunization or the development of a dedicated portfolio, *which are directed toward developing minimum-risk procedures for supporting a prescribed liability schedule*. [*emphasis added*]

This requirement is intended to protect IFAS investments against potential losses, but it also has the effect of inhibiting the program's capacity to realize gains. Limiting investments to low-risk, low-yielding instruments cannot support the plan's benefit requirements without additional funding. The consulting actuary for both the FRS and IFAS, Milliman Inc., has noted that maintaining this funding strategy could add to investment losses and further escalate contribution rates.

Funding imbalance

For several years, relatively small biennial increases to the IFAS plan contribution rate have kept program funding within manageable bounds. But beginning in 2002 the growing funding imbalance required a big increase in employer contribution rates — from 7.17% to 13.83% of affected payroll. The consulting actuary proposed another significant rate increase in the 2004 biennial IFAS plan valuation. Based on data available for fiscal year 2004, a rate of 20.23% was recommended for the IFAS plan beginning July 1, 2005, to support the plan in an actuarially sound manner. While the Legislature set the FY 2005-06 contribution rate at 20.23% of payroll.

Florida Retirement System Pension Plan

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 900 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.

As a defined benefit plan, the FRS "Pension Plan" provides retirement income expressed as a percent of final average 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 one of two Special Risk Retirement 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 or service threshold.

FRS investment policy and restrictions

Section 121.151, F.S., directs the State Board of Administration to invest the assets of the FRS in accordance with the provisions of ss. 215.44 - 215.53. SBA's investment policy objective for the FRS Pension Plan portfolio is to provide investment returns sufficient for the plan to be maintained in a manner that ensures the timely payment of promised benefits to current and future participants and keeps the plan cost at a reasonable level. To achieve these objectives, the Board has determined that a long-term real return of 4.0% per anum (compounded and net of investment expenses) should be attained.

III. Effect of Proposed Changes:

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

Section 1 creates s. 121.047, F.S., 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 IFAS structure as a separate entity distinguishable from the FRS.

Section 2 amends s. 121.40, F.S., 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 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 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:

Effective July 1, 2007, the employer contributions for IFAS plan participants will be reduced from the current 20.23 percent of covered payroll to 18.75 percent. Absent this change the payroll contribution rate for the succeeding plan year will be 28.23 percent of covered payroll.

The Division of Retirement advises that there will be additional cost to the FRS 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 represents the difference between the plan assets and obligations for current and future salaries.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.