The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the General Government Appropriations Committee

BILL: CS/CS/SB 2002

INTRODUCER: General Government Appropriations Committee, Governmental Operations Committee, and Governmental Operations Committee

SUBJECT: FRS/Payroll Contribution Rates

DATE: April 2, 2008 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	**Fav/CS**
2.	McVaney/Pigott	DeLoach	GA	**Fav/CS**
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 Florida Retirement System retirement plan for the fiscal year beginning July 1, 2008. From a budgetary perspective, the bill has no fiscal impact on employers participating in the Florida Retirement System because contribution rates remain unchanged for FY 2008-2009. However, receipts into the Florida Retirement System Trust Fund are reduced by approximately $318.4 million because the contribution rates established in this bill for FY 2008-2009 are reduced below the rates that would have gone into effect July 1, 2008, but for this legislation.

The bill amends section 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 680,000 active and 296,000 retired members and beneficiaries of its more than 900 state and local government public employers.[1] Originally

[1] As of July 1, 2007, the membership was comprised of 680,302 active members and 265,325 retired members. These numbers include 84,766 terminated vested members and 31,562 DROP members.

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 five previously separate pension plans.[2] 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 annuity 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 dates 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.

[2] In addition to the above it includes the Highway Patrol Pension Plan, and the Judicial Retirement System, and, in 2007, the Supplemental Pension Plan for the Institute of Food and Agricultural Sciences at the University of Florida.

Section 121.031(3), F.S., provides that the administrator[3] 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 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).

In 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 $8.2 billion. It has been the recent custom to recognize a portion of these excess actuarial assets as a credit toward the payroll contribution rate structure. Sections 121.031 and 121.0312, F.S., establish a method for the calculation and 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 salary between entry age and assumed exit.

At five year intervals the plan is subject to an experience study in which the morbidity and mortality of plan members is assessed. That study will commence at the beginning of the 2009 fiscal year and will set the experience parameters through the year 2013.

III. Effect of Proposed Changes:

Section 1 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. Normal cost rates do not recognize any surplus amounts.

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[3] Section 121.025, F.S., designates the secretary of the Department of Management Services as the administrator of the retirement and pension systems.
[4] Milliman, "Florida Retirement System Actuarial Valuation as of July 1, 2007."
[5] Section 112.658, F.S.

FRS Actual and Proposed Contribution Rates
For Fiscal Years 2007 and 2008

Retirement Class	CS/SB 2002 (2008) (%)	Normal Cost Rates Based on 2008 Valuation	Actual Rate in Effect FY 07-08 (%)
Regular	8.69	9.60	8.69
Special Risk	19.76	22.03	19.76
Special Risk, Admin.	11.39	11.98	11.39
Elected State Officers	13.32	14.52	13.32
Elected, Judges	18.40	20.37	18.40
Elected, County Off.	15.37	17.06	15.37
Senior Management	11.96	13.36	11.96
DROP	9.80	10.96	9.80

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

Section 3 provides that the bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Subsection (a) of s. 18, Art. VII of the Florida Constitution provides that "no county or municipality shall be bound by any general law requiring such county or municipality to spend funds . . . unless the legislature has determined that such law fulfills an important state interest and unless: . . . the expenditure is required to comply with a law that applies to all persons similarly situated . . .." Subsection (d) of the same section exempts those "laws adopted to required funding of pension benefits existing on" November 4, 1990.

This bill includes a legislative finding that the bill fulfills important state interest, and the bill applies to all persons similarly situated (those employers participating in the Florida Retirement System), including state agencies, school boards, community colleges, counties and municipalities.

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. Fiscal Impact Statement:

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 2008-2009 will be reduced by approximately $318.4 million, which will be offset by the recognition of a like amount of Florida Retirement System actuarial surplus.

Comparing contribution rates established by this bill to the 2007 normal costs determined by the state actuary, employers participating in the FRS will experience a reduction in retirement costs for FY 2008-2009. The reductions by employer group are noted below:

State Agencies	$ 60.6 million
State Universities	9.4 million
Community Colleges	7.5 million
School Boards	116.8 million
Counties	109.1 million
Other	14.9 million
TOTAL	$318.4 million

The revised payroll contributions are electronically transmitted to each of the 900 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 or .01 percent, equals $100 per $1 million of payroll.

VI. Technical Deficiencies:

None.

VII. Related Issues:

This bill 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, specifically the Florida Educational Finance Program and the Community College Program Fund.

By letter dated November 30, 2007, the consulting actuaries to the Florida Retirement System reported their calculation of recommended “blended” rates for the pension plan based upon its calculation of the weighted average rates for the pension and investment plans, using all available excess actuarial assets as provided by the statutory formula:

FRS Blended Contribution Rates (%), FY 2008-2009

Fiscal Year	Regular	Special Risk	Special Risk, Adm.	Judicial	Elected State	Elected County	Senior Mgmt.	DROP
2009	**8.23**	**20.60**	**10.65**	**18.90**	**13.09**	**15.74**	**11.68**	**10.96**

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS/CS by General Government Appropriations on April 2, 2008:

The committee substitute continues the current level of employer contribution rates for the Florida Retirement System through the 2008-2009 fiscal year. Beginning July 1, 2009, the contribution rates are increased to the normal cost of the defined benefit plan under the FRS.

CS by Governmental Operations on March 19, 2008:

The committee substitute does not enact any rates for the 2009 fiscal year and leaves that rate setting to the result of the deliberations that produce the Conference Report on the General Appropriations Act.

B. Amendments:

None.