

**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 Policy and Steering Committee on Ways and Means

BILL: CS/SB 2022

INTRODUCER: Policy and Steering Committee on Ways and Means and Senator Alexander

SUBJECT: Retirement

DATE: March 25, 2010

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	McVaney	Coburn	WPSC	Fav/CS
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**Please see Section VIII. for Additional Information:**

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|------------------------------|-------------------------------------|---|
| A. COMMITTEE SUBSTITUTE..... | <input checked="" type="checkbox"/> | Statement of Substantial Changes        |
| B. AMENDMENTS.....           | <input type="checkbox"/>            | Technical amendments were recommended   |
|                              | <input type="checkbox"/>            | Amendments were recommended             |
|                              | <input type="checkbox"/>            | Significant amendments were recommended |

**I. Summary:**

The bill establishes the required employer payroll contribution rates for each membership class and subclass of the Florida Retirement System (FRS) retirement plan for the fiscal year beginning July 1, 2010. In addition, the bill changes the FRS from a noncontributory system to a contributory system by requiring each active member of the FRS, the Senior Management Service Optional Annuity Program, the State University Optional Retirement Program and the Community College Optional Retirement Program to contribute 0.25% of gross salary to fund retirement benefits, effective January 1, 2011.

If terminated members take a refund of employee contributions, the members forfeit any rights to claim service credit under the FRS for that time period.

The Division of Retirement within the Department of Management Services is appropriated \$445,125 from the FRS Operating Trust Fund and 8 FTE positions to implement the act.

When compared to the contributions rates currently scheduled to be effective July 1, 2010 (but for this legislation), the bill increases retirement contributions for FY 2010-11 by approximately \$49.8 million from employers and \$41.6 million from employees. From a budgetary standpoint,

comparing actual FY 2009-10 contributions to the expected contributions required by the new rates for FY 2010-11, employers will contribute approximately \$425 million more in FY 2010-11. For FY 2011-12, the contribution costs will again increase by \$863.3 million due to the funding of the unfunded actuarial liabilities.

The bill amends sections 121.011, 121.021, 121.051, 121.0515, 121.052, 121.053, 121.055, 121.071, 121.081, 121.091, 121.121, 121.35, 121.4501, 121.4503, 121.571, 121.591, 121.70, 121.71, 121.72, 121.73, 121.74, 121.76, 121.78, and 1012.875, Florida Statutes.

## **II. Present Situation:**

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits to the 572,000 active and 319,000 retired members and beneficiaries of its more than 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 five 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 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.

Section 121.031(3), F.S., provides that the administrator 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 2009 for the FRS plan year ending the prior June 30. By law, 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. As of July 2008, the FRS Trust Fund enjoyed an \$8.2 billion actuarial surplus.

In 2009 the state actuary completed the 5 year Experience Study. This study is to review the actual experience of the retirement system to determine whether the actuarial and behavioral assumptions are reasonable. Based on this Experience Study, the July 2009 Annual Valuation indicated a \$15.4 billion unfunded actuarial liability (UAL) for the system. This increase in the UAL can be attributed to two primary factors – \$18.7 billion of unfavorable investment experience and \$5.85 billion due to changes in actuarial assumptions or benefits (based on the 5 year Experience Study).

Because it has been the recent custom to recognize a portion of these excess actuarial assets as a credit toward the payroll contribution rate structure, the Legislature has enacted employer contribution rates that were below the normal costs of the system for the first year and moved to the normal cost rates for the second and subsequent years.

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.

The state actuary has recently completed a study<sup>1</sup> on the impact of chapter 2009-209, Laws of Florida. The table below shows the normal cost rates and the rates necessary to amortize the UAL over a 30 year period based on this recent study, assuming a blended rate of both the defined benefit plan and the defined contribution plan.

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<sup>1</sup> “Blended Rates for the 2010-2011 Plan Year under House Bill 479 Reflecting a Uniform UAL Rate for all Payroll Bases”, dated February 16, 2010.

<b>Retirement Class</b>	<b>Normal Cost Rate (%)</b>	<b>Rates Necessary to fund UAL (%)</b>	<b>Actual Rate for FY 09-10 (%)</b>	<b>Statutory Rate for FY 10-11 (%)</b>
Regular	9.76%	1.58	8.69	9.63
Special Risk	22.15	5.97	19.76	22.11
Special Risk, Admin.	11.24	15.97	11.39	12.10
Elected, State Officers	14.38	17.05	13.32	15.20
Elected, Judges	19.39	11.00	18.40	20.65
Elected, County Officers	16.62	19.75	15.37	17.50
Senior Management	11.70	9.26	11.96	13.43
DROP	14.23	4.97	9.80	11.14

**III. Effect of Proposed Changes:**

Section 1 amends s. 121.011, F.S., to update the preservation of rights provisions to acknowledge that the members will make contributions to the Florida Retirement System beginning January 1, 2011.

Section 2 amends s. 121.021, F.S., to define the terms “termination,” “benefit,” and “payee.”

Section 3 amends s. 121.051, F.S., to clarify that only at the time of joining the FRS, newly participating employers have the option to provide benefits based on past service. This section also clarifies that any employer-paid employee contributions are subject to federal FICA taxes.

Section 4 amends s. 121.0515, F.S., to provide that the calculation for determining the contributions necessary for upgrading prior special risk service includes employee contributions.

Section 5 amends s. 121.052, F.S., to specify that members of the Elected Officers’ Class will begin paying contributions January 1, 2011. If a member ceases to fill the office for 3 consecutive months for any reason other than retirement, the member is eligible for a refund of the employee contributions; however, by taking such refund the member waives all rights to the service credit under the FRS represented by the refunded contributions.

Section 6 amends s. 121.053, F.S., to make a conforming change in recognition of the employee contributions effective January 1, 2011.

Section 7 amends s. 121.055, F.S., to specify that members of the Senior Management Service Class will begin paying contributions January 1, 2011. If a member terminates employment for 3 consecutive months for any reason other than retirement, the member is eligible for a refund of the employee contributions; however, by taking such refund the member waives all rights to the service credit under the FRS represented by the refunded contributions.

Section 7 also requires participants in the Senior Management Service Optional Retirement Program to make employee contributions effective January 1, 2011. Participants may not take distributions under the program prior to termination for any reason.

Section 8 amends s. 121.071, F.S., to recognize that employees and employers will contribute to the FRS. Refunds of employee contributions do not include any interest earnings, and employer contributions are not refundable. If a defined benefit program member receives an invalid refund, the member must repay the full amount of the invalid refund plus interest.

Section 9 amends s. 121.081, F.S., to specify that to purchase prior service performed after December 31, 2010, for which the member received a refund of employee contributions, the member must contribute the required employee contribution plus interest.

Section 10 amends s. 121.091, F.S., to allow a member to receive a refund of employee contributions once the member has been terminated from covered employment for 3 calendar months.

Section 11 amends s. 121.121, F.S., to specify that the cost of any leave of absence purchased after January 1, 2011, will include both employer and employee contributions.

Section 12 amends s. 121.125, F.S., to clarify the employer's obligation to pay and remit employer and employee contributions in a timely manner when an active member returns to work after an injury or illness covered by worker's compensation.

Section 13 amends s. 121.35, F.S., to require participants in the State University System Optional Retirement Program to make employee contributions effective January 1, 2011. Participants may not take distributions under the program prior to termination for any reason.

Section 14 amends s. 121.4501, F.S., to define "participant contributions" relating to the Public Employee Optional Retirement Program.

Section 15 amends s. 121.4503, F.S., to provide for the deposit of employee contributions into the FRS Contributions Clearing Trust Fund. The Department of Management Services is granted rulemaking authority governing the receipt and disbursement of employee contributions.

Section 16 amends s. 121.571, F.S., to require participants as well as the employer to submit retirement contributions.

Section 17 amends s. 121.591, F.S., to specify that benefits earned under the Public Employee Optional Retirement Plan may not be payable for any reason prior to termination of employment. In addition, any nonvested accumulations will be forfeited upon payment of any vested benefit to a participant or beneficiary. The section also provides that the distribution payment selected by the participant or beneficiary for normal retirement benefits and the retirement of the participant is final and irrevocable at the time the distribution is made.

Section 18 amends s. 121.70, F.S., to modify the stated legislative purpose and intent of the uniform system of funding the FRS to recognize that both employers and employees will be contributing to the system.

Section 19 amends s. 121.71, F.S., to set out the employee rates, the employer rates and the rates to fund any unfunded actuarial liabilities payable by the employers. The employers are permitted to deduct the employee contributions from the employee's monthly gross salary on a pretax basis. Employee contributions are set at 0.25% of gross salary beginning January 1, 2011. The employer contributions are set to meet the blended normal costs of the FRS (the defined benefit and defined contribution plans combined). The contribution rates for the unfunded actuarial liability are set at 0% for FY 2010-2011 and at the blended UAL rate beginning July 1, 2011. Under current law, the UAL rates will also be imposed upon the optional retirement programs offered for the state university system, the community colleges and the Senior Management Service.

Section 20 amends s. 121.72, F.S., to clarify the payment of both employer and employee contributions into the individual accounts of the Public Employee Optional Retirement Program.

Section 21 amends s. 121.73, F.S., to clarify the payment of contributions to fund disability benefits under the Public Employee Optional Retirement Program.

Section 22 amends s. 121.74, F.S., to reduce, for a four year period, the employer contribution paid to the State Board of Administration for administrative and educational expenses from 0.05% of payroll to 0.03% of payroll. Effective July 1, 2014, the contribution rate will increase to 0.04% of payroll.

Section 23 amends s. 121.76, F.S., to clarify that the employer-paid employee contributions are subject to federal FICA taxes.

Section 24 amends s. 121.78, F.S., to require employers to remit both the employer and employee contributions. Contributions that are late are subject to a 1% delinquent fee for each month or portion of a month that the contributions should have been paid. If the employer remits excess employer or employee contributions, the employer will receive a credit against future contributions owed. The employer is responsible for reimbursing an employee for excess contributions.

Section 25 amends s. 1012.875, F.S., to specify that members of the Community College Optional Retirement Program will begin paying contributions January 1, 2011.

Section 26 provides that the act fulfills an important state interest.

Section 27 appropriates \$445,125 from the FRS Operating Trust Fund and authorizes 8 positions for the Division of Retirement to implement the act.

Section 28 provides that the act is effective July 1, 2010.

**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 require 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:**

Each active employee of the FRS, the Senior Management Service Optional Annuity Plan, the State University System Optional Retirement Plan and the Community College Optional Retirement Plan will contribute 0.25% of his/her gross salary on a pretax basis. This equates to approximately \$41.6 million for FY 2010-11 and \$83.2 million annually thereafter.

**C. Government Sector Impact:**

With the enactment of this legislation, the revenues expected to flow into the Florida Retirement System in FY 2010-2011 will increase by approximately \$49.8 million from employers and \$39.4 million from employees when compared to the revenues that would have been contributed based on the current 2010-11 contribution rates in effect.

From a budgetary standpoint, participating employers will pay additional contributions compared to the contribution rates in effect for FY 2009-10. The increases by employer group for FY 2010-11 are noted below:

State Agencies	\$ 71.8 million
State Universities	15.6 million
Community Colleges	11.2 million
School Boards	168.4 million
Counties	134.8 million
Other	<u>20.7 million</u>
TOTAL	\$422.5 million

Effective July 1, 2011, the employers will have increased contributions to fund the unfunded actuarial liabilities of the FRS. The expected increases by employer group for FY 2011-12 are noted below:

State Agencies	\$178.4 million
State Universities	48.7 million
Community Colleges	22.2 million
School Boards	263.8 million
Counties	304.5 million
Other	<u>45.8 million</u>
TOTAL	\$863.3 million

The Division of Retirement within the Department of Management Services is appropriated \$445,125 from the FRS Operating Trust Fund and 8 FTE positions to implement the act.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

The 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.



**VIII. Additional Information:**

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

**CS by the Policy and Steering Committee on Ways and Means on March 25, 2010:**

The committee substitute establishes the required employer payroll contribution rates for each membership class and subclass of the Florida Retirement System (FRS) retirement plan for the fiscal year beginning July 1, 2010. In addition, the bill changes the FRS from a noncontributory system to a contributory system by requiring each active member of the FRS, the Senior Management Service Optional Annuity Program, the State University Optional Retirement Program and the Community College Optional Retirement Program to contribute 0.25% of gross salary to fund retirement benefits, effective January 1, 2011. The committee substitute also appropriates funds and authorizes positions for the Division of Retirement to implement the act.

- B. **Amendments:**

None.