The Florida Senate

Issue Brief 2010-317 *December 2009*

Committee on Governmental Oversight and Accountability

SETTING THE 2010-2011 EMPLOYER CONTRIBUTION RATES FOR THE FLORIDA RETIREMENT SYSTEM

Statement of the Issue

State government pension plans were not insulated from the decline in world capital markets that began in late 2007. The multi-employer Florida Retirement System (FRS) experienced a $23.6 billion swing in asset valuations that eliminated its overfunded status and produced an unfunded liability for the first time since 1997. The Legislature's practice of setting pension plan contribution rates by statute will have to contend with this circumstance which complicates existing difficulties being experienced by all participating government employers in their operating budgets. A recognition of existing pension costs, longer-term benefit pressures, and the sustainability of current compensation practices will be required. The report presents different funding options for consideration.

Discussion

The multi-employer Florida Retirement System (FRS) ceased its twelve-year overfunded status at the close of the plan year in June 2009. A portion of the excess plan assets were used to dampen the normal, long-term cost of the system. The system actuary reported the following change in funding status in the December 2009 reports. Unblended rates do not include the effects of the defined contribution plan; blended rates include them and weight the total contribution proportionately:

FRS Employer Contribution Rates Beginning July 1, 2010

Component	REG	SPECIAL RISK	S RISK ADM	JUD	LEG	COUNTY	SEN MGT	DROP	COMPOSITE
*2009 Valuation, Unblended Rates **without** PEORP*									
Normal Cost	9.99	22.54	11.05	20.28	14.88	17.11	12.09	15.10	12.18
Unfunded Liability	2.02	7.13	20.24	12.71	23.75	26.43	11.95	4.97	3.16
Adjusted Contribution	**12.01**	**29.67**	**31.29**	**32.99**	**38.63**	**43.54**	**24.04**	**20.07**	**15.34**
*2009 Valuation, Blended Rates **with** PEORP*									
Normal Cost	9.25	21.33	11.80	19.63	13.81	16.61	11.21	NA	11.09
Blended Contribution	**11.64**	**28.57**	**27.17**	**32.27**	**31.85**	**37.31**	**21.44**	**20.07**	**14.85**

Source: Milliman, *Florida Retirement System Actuarial Valuation as of July 1, 2009*, December 1, 2009, Table IV-4; blended contribution rates as of December 4, 2009 in correspondence from Robert Dezube, Consulting Actuary, to Sarabeth Snuggs, Director, Division of Retirement, Table I.

The Legislature retains considerable discretion in identifying the funding recognition it wishes to provide for future contribution rates. It may accept the July 1, 2009 rates or, as provided in ss. 121.031(3)(f), F.S., recognize an estimated valuation on December 31, 2009 using asset values in the plan on that date. Since these values may be plausibly higher than those six months earlier, the effect would be to reduce the amount of unfunded liability and, thus, the overall rate increase. The asset value would have to be in the range of $118-$120 billion for a substantial eradication of the unfunded liability, absent other assumptions changes. Such a recognition would not alter the elimination of the surplus. In combination with the completion of the periodic mortality and morbidity study on the plan membership completed in late 2009, there would still be an overall rate increase.[1]

There are other options available to the Legislature to moderate rate increases. Chapter 216, F.S., creates a consensus estimating process for the establishment of pension plan financial assumptions. One or more of these assumptions – salary increases, rate of investment return, and inflation - may be adjusted through the conference process that could offset a rate spike. Reducing future salary increase and estimating investment returns greater than the current 7.75 percent would combine to reduce payroll cost growth, although it would commit the Legislature to lowered expectations on compensation in future years.

Section 112.63, F.S., also authorizes the recognition of an asset valuation corridor between 80% and 120% of market value. Assets may neither fall below the lower number nor exceed the upper limit. Corridor limits have now been implicated due to the nearly $24 billion swing from the prior plan year. This is a significant variable as it implicates an overall plan valuation difference between 88.5 percent and 96.7 percent, or $11 billion. Without the corridor restriction the plan would more closely approach full funding.

The 2009 Legislature directed the completion of an actuarial study on the development of a revised method of recognizing the costs associated with the Deferred Retirement Option Program (DROP). The plan actuary has recommended that the Legislature revise the existing method establishing a uniform rate for all membership classes. This increases charges to members of the Regular Class, about 80 percent of FRS membership, and does not fully recognize the true costs for the other classes. The alternatives include recognizing the DROP component as the same as the class of membership in which the employee works or establishing the DROP cost at zero. This costing exercise has critical policy implications in future budget cycles. Recognizing DROP costs at the normal cost rate will make it more costly to maintain this program as its relative costs will have increased; reducing the rate to zero will make it more attractive and reduce payroll costs, but it may also lengthen average participation to the full sixty month statutory term.

Lastly, another structural option is available to the Legislature. It could return to pre-1975 funding levels in which employees and public officers were required to make a four percent and eight percent pension copayment, respectively. Among state pension plans, full employer-borne costs are relatively uncommon. The positive effect on operating budgets would be substantial and immediate, with a greater impact being experienced by *ad valorem* funded employers that have a larger presence of public safety employees. In this alternative every one percent of salary shifted to the participant represents about $316 million in employer contribution rate savings in the operating budget. The shifting of the expense burden does not change the benefit amount.

The 2009 Legislature eliminated eligibility for a second career pension in the FRS beginning on July 1, 2010. To the extent that retirees return to FRS employment they will not accrue any subsequent pension benefits. There will be no future employer costs other than those imposed for unfunded liability assessments, which are passed along to all FRS membership classes and to those participants who are members of one or more of the optional annuity programs.

The above options are not mutually exclusive and different combinations of them would yield cumulative budget savings to participating FRS employers. The Division of Retirement has reported a sustained growth in employer membership in the FRS for the past three years. Local government employers with their own pension plans are closing them and directing all new hires to the FRS due to its favorable rate structure. Consistent growth in membership tends to restrain future benefit costs and a new "book of new lives" spreads benefit costs over new generations of participants who have distant retirement dates.

[1] Milliman, *June 30, 2008 Experience Study Results of the Florida Retirement System Defined Benefit Program*, October 2009.