

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.)

BILL: CS/SB 2230

SPONSOR: Governmental Oversight and Productivity Committee

SUBJECT: Florida Retirement System

DATE: March 25, 2004 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Wilson</u>	<u>Wilson</u>	<u>GO</u>	<u>Fav/CS</u>
2.	<u>McVaney</u>	<u>Coburn</u>	<u>AP</u>	<u>Favorable</u>
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill establishes the employer payroll contribution rates for the Florida Retirement System beginning July 1, 2004.

The bill amends ss. 121.40, 121.71, and 121.74, Florida Statutes.

II. Present Situation:

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits to the more than 600,000 active and 200,000 retired members and beneficiaries of its more than 800 employers. Originally established in 1970 as the successor to the Teachers' Retirement System (TRS) and the State and County Officers' and Employees' Retirement System (SCOERS), the FRS is today an amalgamation 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 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. The retirement benefit at normal retirement age is calculated by multiplying the member's final average compensation (the average salary over the five highest fiscal years of earnings, adjusted by up to 500 hours of annual leave) by a factor equal to the number of years of creditable service multiplied by the accrual rate for the membership class. The accrual rates range from 1.60 percent for the Regular Class to 3.33 percent for the Justices

and Judges subclass of the Elected Officers Class. For most membership classes, normal retirement occurs at the earlier of thirty years of service or age 62. For public safety employees in the Special Risk Retirement Class, normal retirement occurs at the earlier of twenty-five years of service or age 55. Members seeking early retirement 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 supplemental service. Enrollment in DROP nominally 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 a member an equity interest in the employer's payroll contributions made on the member's behalf and the associated 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 for the Investment Plan due to the incompatibility of plan designs. During the initial enrollment period for the defined contribution plan, each active member of the FRS was given the option to enroll in the new defined contribution plan or maintain participation in the defined benefit plan. After the initial enrollment period, each employee is granted an additional opportunity to change participation between the plans.

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.

It has been custom since the adoption of the Investment Plan to perform annual plan valuations¹ accompanied by the setting of the contribution rates in separate legislation. The annual valuation was received on December 22, 2003, for the FRS plan year ending the prior June 30.² By law³, the Legislature commissions a separate second opinion of that valuation that is performed by the Office of Program Policy Analysis and Governmental Accountability. That opinion, specifically executed by Mellon Human Resources and Investor Solutions was received some 3 weeks later.⁴

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

¹ Section 121.031(3), F.S.

² Milliman USA, "Florida Retirement System Actuarial Valuation as of July 1, 2003."

³ Section 112.658, F.S.

⁴ Mellon Human Resources and Investor Solutions, "Study of the 2003 Actuarial Valuation of the Florida Retirement System," January 13, 2004.

200 active employees and retired beneficiaries.⁵ 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 they escalate. When actual salary increases at a rate less 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.

Since 1998 the FRS Trust Fund began to experience surpluses of assets over liabilities for the first time in its history. It has also 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 mechanism recognizes a portion of any surplus that exceeds nominal percentages of actuarial liabilities may be used to prevent wide variations in employer contributions in any one year.

The table below shows the contribution rates effective July 1, 2003, and July 1, 2004, for each class or subclass as established by the 2002 Legislature.

<u>Class</u>	<u>Current 07-01-03 Rates</u>	<u>Current 07-01-04 Rates</u>
Regular Class	6.18%	10.07%
Special Risk Class	17.32%	22.15%
Special Risk Admin. Support Class	8.71%	12.58%
Elected Officers' Class – Judicial Subclass	17.44%	20.70%
Elected Officers' Class – Leg.-Atty.-Cab. Sub	11.28%	15.48%
Elected Officers' Class – County	14.02%	17.81%
Senior Management Service Class	8.16%	11.59%
Deferred Retirement Option Program (DROP)	8.00%	11.56%

These contributions are paid into the Florida Retirement System Contributions Clearing Trust Fund. Amounts necessary to pay the benefits due under the defined contribution program are transferred into the participants' accounts (for retirement benefits) and into the disability account of the Florida Retirement System Trust Fund (for disability benefits). The remainder of these contributions is transferred to the Florida Retirement System Trust Fund to pay for the benefits due under the defined benefit program.

Based on the 2003 Actuarial Valuation of the Florida Retirement System, the System has an actuarial surplus of \$12.6 billion as of June 30, 2003. Actuarial liabilities increased by \$2.8 billion during between July 1, 2002, and July 1, 2003, while the actuarial value increased only \$2.5 billion during the same period.

In addition to the contribution rates paid by employers for retirement and disability benefits, s. 121.74, F.S., imposes an assessment of 0.10% of payroll to cover the administrative and

⁵ N=236 as of the March 12, 2003 valuation.

educational expenses incurred by the State Board of Administration. This assessment generates approximately \$21.2 million in FY 2003-04 to offset \$17.1 million of anticipated expenses for the year.

III. Effect of Proposed Changes:

Section 1. The bill amends s. 121.71, F.S., to set the employer payroll contribution rates for the defined benefit plan of the Florida Retirement System as follows:

Retirement Class	Current Statutory Rate for FY 2004-05	Proposed Rate for FY 2004-05	Proposed Rate for FY 2005-06 (Normal Cost)
Regular	10.07%	6.20%	9.98%
Special Risk	22.15%	17.34%	22.16%
Special Risk, Admin.	12.58%	8.73%	12.55%
Elected, State Const. Officers	15.48%	11.30%	15.82%
Elected, Judges	20.70%	17.46%	20.78%
Elected, County Off.	17.81%	14.04%	17.73%
Senior Management	11.59%	8.18%	11.64%
DROP	11.56%	8.00%	11.56%

Section 2. Section 121.40, F.S., is amended to continue the IFAS rate at its current 13.83 percent of payroll until its next biennial review on June 30, 2005.

Section 3. The bill amends s. 121.74, F.S., to reduce the administrative assessment from 10 to 8 basis points (.0008) charged by the Board of Administration for the costs of administration of the portable defined contribution plan, "Investment Plan," offered to FRS employees. It also sets the effective date of the cost reduction to begin July 1, 2004. This lower assessment is expected to generate approximately \$17.7 million in FY 2004-05 to offset \$17.1 million of anticipated expenses for the year.

Section 4. The bill provides a declaration of important state interest in compliance with s.18, Art. VII, State Constitution. Several hundred of the FRS employers are cities and counties subject to that amendment.

Section 5. The bill takes effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Article X, Section 14, State Constitution, requires all public sector pension plans to prefund all promised pension benefits in a sound actuarial manner to avoid the intergenerational transfer of unfunded risk.

V. Economic Impact and Fiscal Note:

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 2003-04 will be reduced by approximately \$942 million. The total amount of surplus that will be used to offset such costs is approximately \$942 million.

Comparing the contribution rates that would otherwise be effective July 1, 2004, under current law to the rates established in this bill, employers participating in the Florida Retirement System will enjoy a reduction in retirement costs for FY 2004-05. The reductions by employer group are noted below:

State agencies	\$180.8 million
State Universities	35.4 million
Community Colleges	25.7 million
School boards	398.0 million
Counties	261.6 million
Other	<u>41.0 million</u>
TOTAL	\$942.5 million

The rates set in the bill are less than those recommended in the 2003 actuarial report. The difference, presumably, will be resolved through subsequent upward adjustment of the rates, a recognition of an equivalent amount of actuarial surplus, or some combination of both. The rates recommended by the consulting actuary of the FRS for the plan year beginning July 1, 2004 are: 6.57% (Regular Class); 17.60% (Special Risk Class); 8.99% (Special Risk Administrative Support Class); 17.72% (Elected Officers' Class - Judicial); 11.56% (Elected Officers' Class - State Constitutional Officers;

14.30% (Elected Officers Class - County Officers; 8.44% - Senior Management Class; and 8.15% - DROP.

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 based. Many of the employer-members of the FRS have their operating budgets determined by the shared revenues distributed through the General Appropriations Act.

The payroll contribution rates for the Investment Plan remain fixed and do not vary with the actuarial funding requirements in the same manner as the defined benefit plan. Because a defined contribution plan assures only a contribution and not a result, there can be no unfunded liability on a contributing employer's part.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
