

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: SB/CS 1490

INTRODUCER: Governmental Operations Committee

SUBJECT: Retirement

DATE: April 13, 2007

REVISED: _____

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

I. Summary:

Section 121.031, Florida Statutes, 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, 2007. 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 2007-2008. However, receipts into the Florida Retirement System Trust Fund are reduced by approximately \$327.9 million because the contribution rates established in this bill for FY 2007-2008 are reduced below the rates that would have gone into effect July 1, 2007, 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 600,000 active and 248,000 retired members and beneficiaries of its some 900 state and local government public employers.¹ 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

¹As of July 1, 2006, the membership is comprised of 599,000 active members, 80,000 terminated vested members, 249,000 retired members, and 32,000 DROP members.

previously separate pension plans. Benefit payments are administered by the Department of Management Services (DMS) through its Division of Retirement, while investment management is undertaken by the Board of Administration. Established as a government plan under section 401(a) of 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 percentage 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 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 of service. 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 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, 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.

Section 121.031(3), F.S., provides that the DMS, as 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 2006 for the FRS plan year ending the prior June 30.² By law,³ the Legislature commissions a separate second opinion of that valuation that is performed by the Office of Program Policy Analysis and Governmental Accountability (OPPAGA). That opinion, specifically executed by Gabriel, Roeder, Smith and Company, was received by OPPAGA February 6, 2007.⁴

² Milliman, "Florida Retirement System Actuarial Valuation as of July 1, 2006."

³ Section 112.658, F.S.

⁴ Gabriel, Roeder, Smith & Company, "Actuarial Review of the July 1, 2006 Actuarial Valuation of the Florida Retirement System," received by OPPAGA February 6, 2007. As of this date, the OPPAGA report has not been finalized.

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 \$7.6 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.

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.

**FRS Actual and Proposed Contribution Rates
for Fiscal Years 2007 and 2008**

Retirement Class	SB 1490 FY 07-08 (%)	Normal Cost Rates FY 07-08 Based on 2006 Valuation	Actual Rate in Effect FY 06-07 (%)
Regular	8.69	9.59	8.69
Special Risk	19.76	22.01	19.76
Special Risk, Admin.	11.39	11.90	11.39
Elected State Officers	13.32	14.99	13.32
Elected, Judges	18.40	20.46	18.40
Elected, County Off.	15.37	17.15	15.37
Senior Management	11.96	13.35	11.96
DROP	9.80	11.40	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:

Section 14, Art. X of the State Constitution and Part VII, 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. 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 Trust Fund in FY 2007-2008 will be reduced by approximately \$327.9 million. The total amount of the surplus that will be used to offset such costs is approximately \$327.9 million.

Comparing contribution rates established by this bill to the 2006 normal costs determined by the state actuary, employers participating in the FRS will experience a reduction in retirement costs for FY 2006-2007. The reductions by employer group are noted below:

State Agencies	\$ 64.5 million
State Universities	10.7 million
Community Colleges	8.0 million
School Boards	122.7 million
Counties	107.3 million
Other	<u>14.7</u> million
TOTAL	\$327.9 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) equals \$100 per \$1 million of payroll.

VI. Technical Deficiencies:

None.

VII. Related Issues:

By letter dated December 1, 2006, the consulting actuary to the Florida Retirement System reported its calculation of recommended “blended” rates for the pension plan based upon its calculation of the weighted average rates for the pension and investment plans, prior to using any available excess actuarial assets as provided by the statutory formula:

FRS Blended Contribution Rates (%), FY 2007-2008

Fiscal Year	Regular	Special Risk	Special Risk, Adm.	Judicial	Elected State	Elected County	Senior Mgmt.	DROP
2007-2008	9.55	21.92	11.86	20.42	14.66	17.03	12.95	10.89

VIII. Summary of Amendments:

None.

This Senate Professional Staff Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
