

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** PCB APC 12-03 Retirement

**SPONSOR(S):** Appropriations Committee

**TIED BILLS:** **IDEN./SIM. BILLS:**

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
Orig. Comm.: Appropriations Committee	15 Y, 8 N	Delaney	Leznoff

### SUMMARY ANALYSIS

The Florida Retirement System (FRS) is a multi-employer, contributory plan that provides retirement income benefits to 643,746 active members, 318,881 retired members and beneficiaries, and 45,092 members in the Deferred Retirement Option Program. It is the primary retirement plan for employees of the state and county governments, county school boards, state colleges and universities. The FRS also serves as the retirement plan for employees in cities and special districts that have elected to participate.

Members of the FRS have two plan options available for participation: the defined benefit plan, also known as the pension plan; and the defined contribution plan, also known as the investment plan.

Section 121.031, F.S., requires that an actuarial study of the FRS be provided by the administrator of the system (the Department of Management Services) and for the results to be reported to the Legislature by December 31 of each year. Thereafter, the Legislature uses this report in establishing uniform contribution rates in law during the next legislative session.

Effective July 1, 2012, the bill:

- revises s. 121.72 F.S., to reduce the allocation rates for all retirement classes being deposited into investment plan member accounts.
- revises ss. 121.051 and 1012.875 to reduce the employer contribution rates into the Community College System Optional Retirement Program.
- revises s. 121.055 to reduce the employer contribution rates into the Senior Management Service Optional Annuity Program.
- revises s. 121.35 to reduce the employer contribution rates into the State University System Optional Retirement Program.
- revises s. 121.71 F.S. to adjust the employer contribution rates for the FRS based on the 2011 Actuarial Valuation as adjusted by the changes to the Investment Plan allocations.

The bill conforms the laws to the proposed House of Representatives FY 2012-13 General Appropriations Act (GAA) as retirement contributions are included in the GAA.

The bill has a significant negative fiscal impact to the state and local governments (\$46.9 million in General Revenue and \$102.5 million for all participating entities.) See Fiscal Impact comments for more detail.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### **Background**

##### Florida Retirement System

The Florida Retirement System (FRS) was established in 1970 when the Legislature consolidated the Teachers' Retirement System, the State and County Officers and Employees' Retirement System, and the Highway Patrol Pension Fund. In 1972, the Judicial Retirement System was consolidated into the pension plan. Prior to 1975, members of the FRS were required to make employee contributions. Regular Class members contributed four percent of their salary while Special Risk Class Members contributed six percent. The 2011 Legislature reinstated employee contributions whereby all Class members contribute three percent of their salary.

The Florida Government System Act<sup>1</sup> governs the FRS, which is a multi-employer, contributory plan that provides retirement income benefits to 643,746 active members, 318,881 retirees and 45,092 members of the Deferred Optional Retirement System (DROP)<sup>2</sup>. It is the primary retirement plan for employees of the state and county government agencies, district school boards, community colleges and state universities. The FRS also serves as the retirement plan for 185 municipalities and 243 independent special districts that have irrevocably elected to participate<sup>3</sup>.

The membership of the FRS is divided into five membership classes:

- Regular Class<sup>4</sup>: 561,618 members (87.25 percent)
- Special Risk Class<sup>5</sup>: 72,675 members (11.29 percent)
- Special Risk Administrative Support<sup>6</sup>: 71 members (0.01 percent)
- Elected Officer Class<sup>7</sup>: 2,284 members (0.31 percent)
- Senior Management Services Class<sup>8</sup>: 7,310 members (1.14 percent)

Each class is funded separately based upon the costs attributable to the members of the class.

Members of the FRS have two plan options available for participation:

- The defined benefit plan, also known as the pension plan.
- The defined contribution plan, also known as the investment plan.

##### Investment Plan

In 2000, the Legislature created the Public Employee Optional Retirement Program (Investment Plan), a defined contribution plan offered to eligible employees as an alternative to the FRS defined benefit plan. The investment plan was available for participation as of July 1, 2001.<sup>9</sup> Allocation rates into the accounts were based on the normal costs of the pension plan at the time.

Benefits under the investment plan accrue in individual member accounts funded by employer and employee contributions. Investments are employee-directed into State Board of Administration (SBA)

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<sup>1</sup> Chapter 121, F.S.

<sup>2</sup> As of June 30, 2011 the defined benefit plan had 540,701 active members and the investment plan had 103,045 members. Data received from Division of Retirement staff.

<sup>3</sup> Participating Employer 2011 Report produced by the Division of Retirement.

<sup>4</sup> Members who do not qualify for membership in another class (includes renewed members.)

<sup>5</sup> Members include law enforcement officers, firefighters, correctional officers, correctional probation officers, paramedics, emergency medical technicians, certain professional health care workers, and certain forensic workers.

<sup>6</sup> Members are former members of the special risk class who are transferred or reassigned to an administrative support position in certain circumstances.

<sup>7</sup> Members include holders of specified elected offices in either state or local government.

<sup>8</sup> Members are high level executive or legal staff as provided by law.

<sup>9</sup> Part II, chapter 121, F.S.

approved investment providers. Members of the investment plan contribute three percent of their salaries to their accounts as required by SB 2100 (Chapter No. 2011-68). The remainder of the allocation comes from employer contributions.

A member vests in the investment plan after one-year with an FRS employer. Vested benefits are payable upon termination of employment or death as a lump-sum distribution, roll-over distribution, or periodic distribution. The investment plan also provides disability benefits, which is essentially an option to collect disability benefits as provided in the defined benefit plan.

The SBA is primarily responsible for administering the investment plan.<sup>10</sup> The SBA is comprised of the Governor as chair, the Chief Financial Officer and the Attorney General.

### Pension Plan (Defined Benefit Plan)

The pension plan is administered by the secretary of the Department of Management Services through the Division of Retirement. Investment management of retirement funds is handled by the State Board of Administration.

The 2011 Legislature made significant changes to the pension plan of the FRS in SB 2100 (Chapter No. 2011-68), which resulted in a significant decrease in the required employer contribution rates, but made no changes to the allocations into members' investment accounts, which created a funding and potential benefit inequity. Changes specifically to the pension plan included:

- Increasing the retirement age and years of service for all retirement classes for new enrollees;
- Decreasing the interest rate earned on DROP accounts from 6.5 to 1.3 for future DROP participants;
- Increasing the vesting period from 6 to 8 years for new enrollees;
- Increasing the period used in determining the Average Final Compensation from 5 to 8 years for new employees.

Participants of the pension plan were also required to contribute three percent of their salary the same as investment plan participants.

### Optional Retirement Programs

Eligible employees may choose to participate in one of the optional retirement programs instead of participating in the FRS:

- Members of the Senior Management Service Class may elect to enroll in the Senior Management Service Optional Annuity Program.<sup>11</sup>
- Members in specified positions in the State University System may elect to enroll in the State University System Optional Retirement Program.<sup>12</sup>
- Members employed by a Florida college may elect to enroll in the State Community College System Optional Retirement Program.<sup>13</sup>

The distributions into these accounts are funded by both employer and employee contributions. Participants in these programs are also required to contribute three percent of their salaries to the plan per Chapter No. 2011-68, while the employer contributions vary by Retirement Class. As noted above, significant changes were made to the defined benefit plan, but as with the allocations for the investment plan, the employer contribution rates for the optional retirement programs remained unchanged.

### Contribution Rates

FRS employers are responsible for contributing a percentage of a member's monthly salary to the FRS Contributions Clearing Account Trust Fund in the Division of Retirement to fund the program. The

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<sup>10</sup> Section 121.4501, F.S.

<sup>11</sup> Section 121.055, F.S.

<sup>12</sup> Section 121.35, F.S.

<sup>13</sup> Sections 121.051 and 1012.875, F.S.

employer contribution is a “blended contribution rate” set by statute<sup>14</sup>, as amended by the Legislature based on an annual actuarial valuation. The rate consists of a blending of the actuarially determined contribution rates necessary to fund the pension plan’s normal cost and the allocations being made into investment plan accounts. The purpose of the blending is to establish the same employer contribution rates regardless of whether an employee participates in the pension plan or the investment plan.

### Effects of the Bill

The bill reduces the employer share of the allocation into the investment plan and employer contributions into the optional retirement plans to a level more in line with the actuarial normal costs determined in the July 1, 2011 Valuation.

The chart below provides a comparison of current employer distributions or allocations, as appropriate, to proposed rates provided in the bill. The chart illustrates that the proposed rates are closer to the actuarially determined normal cost rates for employers for the defined benefit plan than in fiscal year 2011-2012.

<b>Comparison of Employer Contributions Rates <sup>1</sup></b>									
<b>Defined Benefit, Optional Retirement Plans and Investment Plan Allocation</b>									
Membership Class	Normal Cost Defined Benefit Plan			Investment Plan Allocation <sup>2</sup>		Senior Mgt. Optional Retirement Plan <sup>3</sup>		University and State College ORPs <sup>3</sup>	
	2010-11	2011-12	2012-13	Current Rates	Proposed 2012-13	Current Rates	Proposed 2012-13	Current Rates	Proposed 2012-13
Regular Class	9.99%	3.55%	3.54%	6.25%	4.22%			7.43%	5.40%
Special Risk Class	22.54%	10.76%	10.74%	18.33%	12.64%				
Special Risk Administrative Class	11.05%	3.94%	3.43%	8.90%	4.77%				
Elected Officer Class									
Leg/Gov/SAs/PDs	14.88%	6.58%	6.38%	10.81%	7.49%				
Judges	20.28%	10.00%	9.93%	16.63%	11.61%				
County Officers	17.11%	8.23%	8.20%	13.61%	9.55%				
Senior Management	12.09%	4.80%	4.80%	8.21%	5.65%	9.49%	6.93%		

<sup>1</sup> Does not include 3 percent employee contribution that went into effect July 1, 2011

<sup>2</sup> Includes disability contribution that varies by retirement class.

<sup>3</sup> Incorporates an amount similar to the employer's Health Insurance Subsidy contribution.

In addition, the bill accounts for an increase to the normal costs of the FRS as determined by the July 1, 2011 Annual Valuation necessary to adequately fund the program. The normal costs were ‘blended’ with the proposed investment plan allocations to establish employer contribution rates. In addition, the bill maintained the same contribution rates for the Unfunded Actuarial Liability that were in effect for fiscal year 2011-2012. The proposed employer contributions for fiscal years 2012-2013 and 2013-2014 are contained in the table below. The rates for fiscal year 2013-14 are included in the bill to ensure the actuarial soundness of the fund if the Legislature fails to pass legislation to set rates during the 2013 Session, or if the Governor vetoes such legislation.

<sup>14</sup> Sections 121.031 and 121.71, F.S.

Proposed FRS Employer Contribution Rates<sup>15</sup>

Membership Class	"Blended" Normal Costs		Unfunded Actuarial Liability	
	7/1/2012	7/1/2013	7/1/2012	7/1/2013
Regular Class	3.65%	3.65%	0.49%	2.02%
Special Risk Class	11.05%	11.05%	2.75%	7.03%
Special Risk Administrative Class	3.78%	3.78%	0.83%	27.04%
Elected Officer Class				
Leg/Gov/SAs/PDs	6.68%	6.68%	0.88%	27.18%
Judges	10.06%	10.06%	0.77%	16.38%
County Officers	8.59%	8.59%	0.73%	23.01%
Senior Management	5.01%	5.01%	0.32%	11.25%
DROP	4.33%	4.33%	0.00%	6.21%

**B. SECTION DIRECTORY:**

Section 1: Amends section 121.051 to reduce the employer contribution rate for participants in the Community College System Optional Retirement Program, effective July 1, 2012.

Section 2: Amends section 121.055 to reduce the employer contribution rate for participants in the Senior Management Service Optional Annuity Program, effective July 1, 2012.

Section 3: Amends section 121.35 to reduce the employer contribution rate for participants of the State University System Optional Retirement System, effective July 1, 2012.

Section 4: Amends section 121.71 to set the employer contribution rates for each class and subclass of the FRS pension plan for normal costs as well as to address the unfunded actuarial liability for fiscal years 2012-2013 and 2013-14.

Section 5: Amends section 121.72 to reduce the allocations to investment plan participants, effective July 1, 2012.

Section 6: Amends section 1012.875 to conform to changes made in Section 1 of the bill.

Section 7: Provides legislative findings and provides that the act fulfills an important state interest.

Section 8: Provides and effective date of July 1, 2012.

**II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

**A. FISCAL IMPACT ON STATE GOVERNMENT:**

1. Revenues:

None.

2. Expenditures:

See Fiscal Comments Section.

<sup>15</sup> Do not include Health Insurance Subsidy Contributio (1.11 percent) or Administrative Fee (.03 percent)

**B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

1. Revenues:

None.

2. Expenditures:

See Fiscal Comments Section

**C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:**

None.

**D. FISCAL COMMENTS:**

The cost (savings) for major issues in the bill are broken out in the following chart (millions \$):

	Fund Normal Cost Increase (cost)		Adjust Employer IP and ORP Rates (savings)		Net Difference (cost)	
	GR	TF	GR	TF	GR	TF
<b>Entities Funded by the State</b>						
State	24.7	24.7	(11.4)	(11.4)	13.3	11.4
County School Boards	99.4		(40.1)		59.3	
State Universities	9.6		(39.5)		(29.9)	
State Colleges	7.2		(3.0)		4.2	
<i>Total</i>	<i>140.9</i>	<i>24.7</i>	<i>(94.0)</i>	<i>(11.4)</i>	<i>46.9</i>	<i>11.4</i>

<b>Other Entities not Funded by the State</b>						
Counties	91.3		(43.5)		47.8	
Municipalities/Special Districts/Other	14.5		(6.7)		7.8	
<i>Grand Total</i>	<i>246.7</i>	<i>24.7</i>	<i>(144.2)</i>	<i>(11.4)</i>	<i>102.5</i>	<i>11.4</i>

**III. COMMENTS**

**A. CONSTITUTIONAL ISSUES:**

1. Applicability of Municipality/County Mandates Provision:

The mandates provision appears to apply because this bill requires counties and/or cities to spend money or take action that requires the expenditure of money; however, an exception applies as the Legislature has determined that this bill satisfies an important state interest. In addition, similarly situated persons are all required to comply.

**Contractual Obligations**

Article I, s. 10 of the State Constitution prohibits any bill of attainder, ex post facto law, or law impairing the obligation of contracts from being passed by the Florida Legislature.

The Florida Statutes provide that the rights of members of the FRS are of a contractual nature, entered into between the member and the state, and such rights are legally enforceable as valid contractual

rights and may not be abridged in any way.<sup>16</sup> This “preservation of rights” provision<sup>17</sup> was established by the Florida Legislature with an effective date of July 1, 1974.

The Florida Supreme Court has held that the rights provision was not intended to bind future legislatures from prospectively altering benefits which accrue for future state service.<sup>18</sup> The prospective application could only alter future benefits. Those benefits previously earned or accrued by the member, under the previous benefit structure, must remain untouched and the member continues to enjoy that level of benefit for the period of time up until the effective date of the proposed changes. Further, once the participating member reaches retirement status, the benefits under the terms of the FRS in effect at the time of the member’s retirement vest and cannot be adversely altered.<sup>19</sup>

The Florida Supreme Court further held that the “preservation of rights” provision was not intended to bind future legislatures from prospectively altering benefits which accrue for future state service.<sup>20</sup>

This bill does not change any benefits that a member has earned prior to July 1, 2012. The bill only makes changes on a prospective basis. As such, it does not appear to impair the contractual obligation between the FRS employer and the FRS member.

**B. DRAFTING ISSUES OR OTHER COMMENTS:**

None.

**IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES**

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<sup>16</sup> Section 121.011(3)(d), F.S.

<sup>17</sup> The “preservation of rights” provision vests all rights and benefits already earned under the present retirement plan so the legislature may now only alter benefits prospectively. *Florida Sheriffs Association v. Department of Administration, Division of Retirement*, 408 So.2d 1033, 1037 (Fla.1981).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*