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Evaluating Pension Options

Florida Association of Special Districts
Annual Conference

June 4, 2009

James W. Linn

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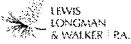
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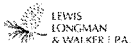


Big Picture

- Special Districts, like local governments across Florida, are facing extreme challenges of
 - declining revenues and
 - increasing costs
- Among the largest and fastest growing costs facing Districts is the cost of employee pension plans

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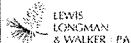


Impact of "Economic Tsunami"

- Most public pension plans had investment losses of between 10% and 15% in year ending 9/30/08
- Most public pension plans have had investment losses of between 15% and 25% since 10/1/08
- What does this mean for Special District Pension Funds?

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Impact of "Economic Tsunami"

- If no changes are made, District pension costs will likely increase dramatically beginning 10/1/09, and each year for the next 5 years.
- The actuarial assumptions that have driven pension costs for the past 20 years may be unrealistic. Adopting more realistic assumptions will add to pension costs.

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5 Year Smoothing - Example

- Assumed rate of return = 8.5%
- Actual return = minus 10.4%
- Actuarial Loss = minus 18.9%
 $[(\text{Minus } 8.5\%) + (\text{minus } 10.4\%)] = \text{minus } 18.9\%$
- $18.9/5 = 3.8$
- Minus 3.8% will be recognized each year for the next 5 years
- Result: required District contributions will likely increase

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What Are the Options to Contain Pension Costs?

- No "silver bullet"
- Keep current pension plans, but:
 - Reduce benefits
 - Increase employee contributions
- Terminate, freeze or close current pension plans, and set up lower cost plans

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How Pension Plans Work

2 types of plans:

- Defined benefit – benefits based on a formula:
 $\text{years service} \times \text{avg. final earnings} \times \text{benefit factor}$
- Defined contribution – individual accounts made up of employer and employee contributions, plus investment earnings. Benefits are based on whatever is in the account.

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How Pension Plans Work

- Defined benefit – District bears risk of investment loss. By law, District must fund the plan on a "sound actuarial basis."
- Defined contribution – employees bear risk of investment loss. District's cost limited to whatever District decides to contribute (i.e., no actuarial surprises).

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How Pension Plans Work

Most District Plans are defined benefit plans

District's contribution requirements determined by actuary:

- Value of promised benefits
- Allocated over 30 years
- Based on assumptions

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Key Actuarial Assumptions

- Investment Earnings
- Salary Increases
- Retirement Rates

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Investment Earnings

- Majority of pension funding is assumed to come from investment earnings – not contributions

Compare Actual Investment Earnings v. Assumption

<u>Actual (10 yr. Avg.)</u>	<u>Assumed</u>
6.07%	8.5%

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Salary Increase

Compare Actual Salary Increase v. Assumption

<u>Actual (10 yr. Avg.)</u>	<u>Assumed</u>
7.65%	4.90%

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What happens if assumptions aren't met?

- Actuarial Loss
- Increase in unfunded actuarial liabilities
- Increase in required contributions
- Because employee contributions are fixed, District contributions go up

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Ch. 175/185 Premium Taxes

- Chapters 175 and 185, F.S. provide for a rebate of the state excise tax on property and casualty insurance premiums to cities that have local pension plans for police officers and firefighters.
- The premium tax monies must be used exclusively for police and firefighter pensions, and the local pension plan must comply with the requirements of Chapters 175 and 185.

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Ch. 175/185 Premium Taxes

- Amount of Ch. 175 premium taxes that can be used to reduce the District's required contributions is based on "base" or "frozen" amount.
- Base/Frozen Amount = amount received in 1998 plus amounts used for minimum benefits and extra benefits since 1998.

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Ch. 175/185 Premium Taxes

- In many Districts, the "Base/Frozen" amount is a small portion of overall premium tax revenues received.
- PT revenues above the "Base/Frozen" amount must be used for additional extra benefits.
- Possible Option: "Stop/Restart" -- converts old benefits into extra benefits, allowing use of more PT revenues to reduce District cost.

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Ch. 175/185 Premium Taxes

“Share Plans”

- Provide an additional benefit to retiring firefighters and police officers.
- Premium tax monies are allocated to individual member accounts in accordance with a formula contained in the plan.
- Share account monies are invested; member accounts are credited each year with investment gains (losses).

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Florida Retirement System

- FRS contains two retirement plan options:
 - a defined benefit plan (“Pension Plan”), and
 - a defined contribution plan (“Investment Plan”).
- Upon joining FRS, an employee can elect to participate in one plan or the other.
- FRS members can also make a 2nd election.

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Florida Retirement System

- **FRS Pension Plan** – benefits are based on a fixed formula: years of service x avg. final compensation x benefit multiplier
- Risk of loss is on system/employers
- The overwhelming majority of FRS members are in the Pension Plan.


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Florida Retirement System

- **The FRS Investment Plan** – benefits are based on funds contributed to individual member accounts, plus investment earnings or losses [like a 401(k) plan]
- Members may direct the investment of their plan account in a variety of investments.
- Risk of loss is on employees.

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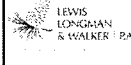
FRS Participation Requirements

A local government may elect to participate in the Florida Retirement System at any time, for any of 3 employee groups:

- General Employees
- Police Officers
- Firefighters

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FRS Participation Requirements

- Joining FRS means a change in pension benefits which is subject to collective bargaining with unions.
- As a condition of FRS participation, social security coverage is mandatory for all employees who join FRS.

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FRS Contributions

- FRS - funded solely by employer contributions.
- Contribution rates set by the legislature based on annual actuarial reports.
- Current FRS Pension Plan contribution rates:
 - regular (general employees) -9.85%
 - senior management -13.12%
 - special risk -20.92%
 - elected officials -16.53%

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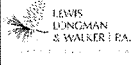


FRS Contributions

- Current FRS Investment Plan contribution rates:
 - regular (general employees) -10.41%
 - senior management - 12.37%
 - special risk -22.49%
 - elected officials -17.77%

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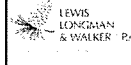
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FRS Contribution Rates will Probably Increase

- FRS has suffered significant investment losses in the past year.
- Difference between FRS and most local government pension plans: FRS was fully funded (had a surplus) as of 2008.
- FRS contribution rates will likely increase over the next few years, from 3% to 6% (estimated).


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Transition to FRS: 2 Approaches

1. Terminate or freeze current District plan
- all employees join FRS.
2. Close current District plan to new members— all new hires join FRS; members of closed District plan may elect to stay in District plan or join FRS.


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FRS Transition

- If current District pension plan is closed, all current plan members have individual right to elect to stay in District plan, or join FRS
- FRS statute provides additional "referendum" for firefighters; but this is typically handled through collective bargaining process.

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Terminate or Freeze Current District Plan

- Current plan would terminate or benefit accruals would be frozen on a date certain.
- All members would become fully vested in their accrued benefit.
- Loss of future premium tax revenues
All employees would become members of FRS.

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Terminate or Freeze Current District Plan

- Fire plan termination -- pension board determines how accrued benefits are to be distributed (present value paid in cash lump sum, substitute trust, annuities, etc.).
- District must pay any deficiency (difference between plan assets and termination liability).

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Close Current District Plan

- Current District plan would be closed to new members on date District joins FRS.
- Closed District plan continues in operation until the last benefit is paid out or until "fully funded."
- Members of closed District plan can elect to stay in District plan or join FRS.
- All employees hired after date District joins FRS become members of FRS.

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FRS Past Service Credit

- An employee who joins FRS cannot obtain credit under FRS for past service with the District for which the employee will receive a benefit from the District pension plan.
- In other words, if you elect to join FRS you cannot get credit under FRS for any service with the District that entitles you to a benefit under the District plan.

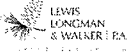
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FRS Past Service Credit

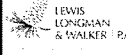
- If District plan is terminated or frozen, all members of the plan become vested in the benefit accrued to date of termination/freeze.
- The members would then be entitled to a benefit from the terminated District plan.
- Because they will receive a benefit from the District plan, the members are not eligible for past service credit under FRS, unless...

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FRS Past Service Credit

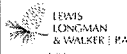
- In order for members of the District plan to be able to join FRS and obtain credit under FRS for their years of service with the District, they would have to waive their right to receive benefits from the District plan.
- They would then receive a refund of their member contributions (with interest), but nothing more, in order to be eligible to obtain credit for their past District service under FRS.

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FRS Past Service Credit

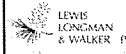
- To allow vested members of the District pension plan to obtain past service credit under FRS, the District plan would have to be amended to permit members to opt out and waive their right to a benefit under the District plan.
- No one can be compelled to waive their right to a benefit under the District plan.

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FRS Past Service Credit

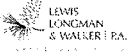
- Past service credit under FRS may be purchased by the District, by employees, or by a combination of both.
- State law does not permit the local government to purchase upgraded past service credit on behalf of elected officers.

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FRS Past Service Credit

- If the District intends to purchase past service credit for employees who elect to join FRS, this must be specified in the FRS participation agreement at the time the District joins FRS.

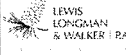
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FRS Past Service Credit Special Risk Benefit “Glitch”

- Although the FRS special risk benefit rate is 3% of AFC for each year of service, the benefit rate for the past service of special risk members is limited to 2% of AFC for each year purchased.


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FRS Past Service Credit Special Risk Benefit “Glitch”

- Most members will not elect to give up their right to a 3% benefit under the District plan to obtain for a 2% benefit under FRS.
- As a result, most members will elect to stay in the District plan after the District joins FRS, which increases the pension costs borne by the local government.

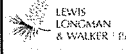
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Joining FRS – Advantages

- Competitive benefit structure for firefighters
- Provides portable pension benefit
- Reduces District pension costs in long-term; but total District pension costs could increase in the short term
- Gets District out of pension business
- Reduces and eventually eliminates actuarial funding obligations for District plans

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Joining FRS – Disadvantages

- Total District pension costs will likely increase for several years; cost savings may not occur for 10-15 years
- Control over pension benefits and cost shifts to legislature

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REPLY TO: TALLAHASSEE

MEMORANDUM

TO: Municipal and Special District Clients

FROM: Jim Linn and Glenn E. Thomas

DATE: May 8, 2009

RE: 2009 Retirement Legislation – Final Report

The 2009 session of the Florida Legislature, extended by one week to finalize the state budget, adjourned on May 8. The session was dominated by the economic downturn and the need to reduce state expenditures. Only three significant retirement bills passed this year:

- HB 538 – revising Chapters 175 & 185, concerning firefighter and police pensions;
- HB 479 – the FRS “double dipping” bill; and
- SB 1802 – setting FRS contribution rates

In addition to the above bills, another bill passed (HB 453) that allows insurance companies to take a credit against state premium taxes for contributions made to eligible scholarship funding organizations (i.e., organizations that pay for poor students to attend private schools). However, there is a provision in the bill that should eliminate any impact on the premium tax revenues received by cities and special districts pursuant to chapters 175 and 185, Florida Statutes.

A summary of the retirement bills that passed this year follows. The Governor must sign the bills or allow them to become law before they can take effect. Copies of any bill can be obtained via the Internet, by accessing the Legislature’s website at www.leg.state.fl.us. If you have specific questions about any bill, please feel free to call us.

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May 8, 2009

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2009 Retirement Legislation that Passed

SB 538 (Firefighter and Police Officer Pensions) (by Sen. Baker). This bill makes several changes to Chapters 175 and 185, Florida Statutes, relating to police and firefighter pension plans. Sen. Bennett (R-Bradenton) made an effort to amend the bill on the Senate floor to allow cities and fire districts to use additional premium taxes received during the next 2 years to reduce their required contributions to the pension plan. However, the amendment did not pass.

In its final form, SB 538 contains the following provisions:

- Expands the definition of “creditable service” to allow credit for federal, other state or county service as a firefighter or police officer, if such credit is provided by the pension plan;
- Codifies the decision of the 4th District Court of Appeal in the Town of Lake Park case (966 So. 2d 448), which held that the employer is responsible for funding any deficiency in a police or firefighter pension plan upon termination of the plan;
- Clarifies the term “firefighter” to include certified supervisory and command personnel;
- Increases the terms of pension board members from 2 to 4 years, if provided by ordinance, resolution, or special act;
- Clarifies that retirees may change their designation of joint annuitant or beneficiary two times without pension board approval, without proof of good health of the joint annuitant being removed, and with no requirement that the current joint annuitant be alive;
- Authorizes deductions from pension benefits for accident, health and long-term care insurance premiums for retirees and beneficiaries;
- Increases the maximum investment in foreign securities from 10% to 25% of plan assets, on a market value basis;
- Clarifies certain issues regarding the annexation of property within fire control district boundaries and the collection of premium taxes;
- Beginning January 1, 2010, pension boards must sell, redeem, divest, or withdraw all publicly traded securities they may have in “scrutinized companies” (companies that do business with countries that engage in terrorism). Divestiture must be completed no later than September 30, 2010.
- Amends the FRS investment plan to require that at least one “terror-free” investment product be provided to plan participants no later than March 1, 2010.

SB 538 takes effect July 1, 2009.

May 8, 2009

Page 3

HB 479 (Florida Retirement System – “double dipping” and other provisions) (by Rep. Schenck). This is the FRS “double-dipping” legislation that has been reported on extensively. The bill was substantially amended and debated in the final days of the session. As passed, the bill contains the following changes to the Florida Retirement System:

- **Definition of “Termination”** -- amends the definition of “termination” of employment effective July 1, 2010 to require a 6 month break in employment with any FRS employer. If an FRS member retires on or after July 1, 2010 and is reemployed by any FRS employer within 6 months following retirement, termination will be deemed not to have occurred, and the member and employer will be jointly and severably liable for reimbursement of any retirement benefits that may have been paid.
- **Reemployment/Break in Service** -- an FRS member who retires or enters the DROP on or after July 1, 2010 can be reemployed by an FRS employer after a break in FRS employment of at least 6 months, but cannot receive both a salary and FRS benefits for 6 calendar months after meeting the definition of “termination.” Translation: In order for an FRS member who retires or enters the DROP on or after July 1, 2010 to be reemployed by an FRS employer and receive both salary and FRS retirement benefits, the member must wait 1 year from date of termination.
- **Reemployment/Renewed FRS Membership** -- effective July 1, 2010, an FRS member who retires or enters the DROP and is later reemployed by an FRS employer cannot renew membership in FRS. Moreover, the employer of the reemployed member must pay FRS contributions equal to the unfunded actuarial liability portion of the employer contribution (currently zero, but expected to increase next year due to FRS trust fund investment losses).
- **City and Special District Elected Officers:**
 - for cities and districts that now participate in FRS but have not designated their elected officials for participation in the FRS elected officers class, the city/district may pass a resolution designating their elected officers to participate in the elected officers class **between July 1 and December 31, 2009.**
 - cities and districts that do not now participate in FRS may designate their elected officials for participation in the FRS elected officers class **at the time they join FRS.**
- **Elected Officers Generally:**
 - An FRS retiree who is elected to office on or after July 1, 2010 may not renew membership in FRS.

- An FRS member who is elected or appointed to an elective office and who participates in the DROP is not subject to termination of employment at the end of the DROP period. However, at the end of the 60 month DROP period the officer's DROP account will not continue to receive additional monthly benefits, but (for those officers who enter the DROP before July 1, 2010) will continue to earn 6.5% interest. Elected officers who enter the DROP on or after July 1, 2010 will not earn interest on their DROP account at the conclusion of the 60 month DROP period.
 - An elected officer may voluntarily terminate employment at any time after the 60 month DROP period ends, but until employment terminates, the officer is not eligible for renewed membership in FRS and cannot receive FRS pension payments, DROP payments, or any other state payment other than the statutory salary, travel and per diem for the elected office.
- **DROP** – effective July 1, 2009, an FRS member may elect to participate in the DROP with no reduction in the maximum DROP period by making the DROP election within 12 months after first reaching the normal retirement date. A member who delays DROP participation beyond 12 months following the normal retirement date loses one month of DROP participation for each month delayed.

HB 479 takes effect July 1, 2009.

CS/SB 1802 (FRS Contribution Rates). This bill sets the payroll contribution rates for the Florida Retirement System for the state fiscal years beginning July 1, 2009 and July 1, 2010. The bills continue the current FRS contribution rates for the state fiscal year beginning 7/1/09. However, beginning July 1, 2010, the rates (excluding the 1.11% Health Insurance Subsidy Contribution and .05% Administrative Fee) will be as follows:

FRS Membership Class	Employer Contribution Beginning 7/1/09	Employer Contribution Beginning 7/1/10
Regular	8.69%	9.63%
Special Risk	19.76%	22.11%
Judges	18.40%	20.37%
State Atty./Public Defender	13.32%	15.20%
County, City, Sp. District. Elect. Offc.	15.37%	17.50%
Special Risk Adm. Support	11.39%	12.10%
Senior Management (SMSC)	11.96%	13.43%