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REPLY TO: TALLAHASSEE

MEMORANDUM

TO: Municipal and Special District Clients

FROM: Jim Linn and Glenn E. Thomas

DATE: January 3, 2011

RE: Preview of 2011 Public Pension Reform Proposals

With newly-elected Governor Rick Scott and three new cabinet members taking office on January 4, and a "veto-proof" Republican majority in both houses of the Florida legislature, 2011 is shaping up as a pivotal year in Florida government. Based on public statements of Governor Scott and legislative leaders, as well as recent reports by Scott's transition team and Florida Tax Watch, one of the top priorities of state leaders will be reforming state and local government retirement programs.

A few recent quotes underscore the importance of pension reform to the 2011 political agenda:

- "At every level of government---local, state and federal,--public sector pensions are a ticking fiscal time bomb. Florida has to bring its pension system into line with other states' plans by increasing employee contributions. Doing that will save almost 1.4 billion dollars." [Governor-Elect Rick Scott speech to Florida Council of 100, November 18, 2010].

- "The plan right now is that everything [concerning public pensions] is on the table. Our state employees have the best deal in the country. They don't contribute and that's wrong." [State Senator Jeremy Ring, Chairman, Florida Senate Committee on Governmental Oversight and Accountability, December 7, 2010].

- "Better leveraging our scale and consistency across state employees (example: performing a comprehensive review of civil service retirement and healthcare benefits and evaluating the cost savings to consolidate plans or programs)." [Governor-Elect Rick

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Scott's Good Government Transition Team – Department of Management Services Key Findings, December 2010].

- "Florida's defined contribution plan is currently an option for state and local government employees in the Florida Retirement System (FRS) and removes the state's obligation from paying predetermined retirement benefits. Switching all FRS members to a defined contribution plan and eliminating the defined benefit plan would save the state significant funds as contributions would no longer be determined by the necessary amount needed to cover future pension payments." [Report and Recommendations of the Florida Tax Watch Government Cost Savings Task Force for FY 2011-12, December 2010].

- "The Florida League of Cities will support legislation that provides comprehensive municipal firefighter and police officer pension reform. Pension mandates directly conflict with the Legislature's desire to limit government spending." [Florida League of Cities 2011 Legislative Action Agenda].

Senate Committee on Governmental Oversight and Accountability

The Senate Committee on Governmental Oversight and Accountability will be the Senate's main venue for pension reform this year. The Committee held its first hearing on state and local government pension issues in December. State Division of Retirement Director Sarabeth Snuggs presented an overview of the Florida Retirement System. FRS now has nearly one million active, retired and vested terminated members. FRS members may elect to participate in the defined benefit or defined contribution plan. About 80% of FRS members participate in the defined benefit plan, and 20% in the defined contribution plan. Since the Florida Retirement System was established in the 1970s, the program has been funded entirely by employer contributions. The current FRS contribution rates are shown below.

FRS Membership Class	**Current Employer Contribution**
Regular	9.63%
Special Risk	22.11%
Judges	20.65%
Elected County Officers	17.50%
Other Elected Officers	15.20%
Special Risk Adm. Support	12.10%
Senior Management (SMSC)	13.43%
DROP	11.14%

Note: the above rates do not include the FRS health insurance subsidy contribution (currently 1.11%) or the administrative/education fee (now .05%).

The total annual payroll of active FRS members is about $27 billion. More than two-thirds of the total is made up of school district (48%) and county (23%) employees. State employees account for about 18% of the total, with city and special district employees making up about 6%. Thus, any move to require employee contributions or reduce benefits will have a much greater impact on local governments/employees than on the state.

Florida League of Cities' Proposals

The Florida League of Cities and Florida Association of Counties presented their proposals for pension reform at the December meeting of the Senate Governmental Oversight and Accountability Committee meeting. Among the League's proposals were the following:

- Require that determinations of average final compensation in defined benefit pension plans include salary only, and do not include pay for overtime, unused leave time or any other additional payment.

- Allow recipients (cities and special districts) of insurance premium tax revenues under Chapters 175 or 185, Florida Statutes, to use these funds to pay for the cost of current benefits and to lower required plan contributions from the plan sponsor.

- Allow cities to convert firefighter and police officer defined benefit pension plans operating under Chapters 175 or 185, Florida Statutes, to the Florida Retirement System (FRS) or another type of plan without losing insurance premium tax revenues.

- Allow cities desiring to place their public safety officers into the Special Risk Class of the FRS the opportunity to purchase past credit service at a 3 percent benefit rate rather than the current 2 percent.

- Allow deviation from state requirements if agreed to by the employees or their union.

- Restrain the Florida Division of Retirement's non-rule-based administrative activities and restrict the Division's broad interpretations of the provisions in Chapters 112, 175 and 185, Florida Statutes, that result in increased costs to pension plan sponsors.

- Change the governance structure of pension boards of trustees to move away from having plan participants serve on the boards.

- Provide flexibility to local governments in the FRS by allowing them to either retain a standard defined-benefit plan, or at the employer's option move to a different retirement plan, such as a hybrid or modified "defined-benefit/defined-contribution" plan.

Employee and union representatives have been invited to make presentations on pension issues at the next meeting of the Senate Governmental Oversight and Accountability Committee meeting, scheduled for January 12.

Florida Tax Watch Recommendations

Also in December, Florida Tax Watch's Task Force on Government Cost Savings issued a 233 page report containing a number of recommendations for reducing the cost of state government. The first chapter of the Tax Watch report is devoted to pension reform. The Task Force recommended a number of specific changes to the Florida Retirement System, including closing the defined benefit plan and requiring all future members to participate in the defined contribution plan, and requiring all current FRS members to contribute to the system. If all the Task Force recommendations were implemented, Tax Watch estimates that the resulting savings would total more than $1 billion annually. A summary of the Tax watch recommendations follows.

- Eliminate or reduce FRS defined benefit plan utilization and concurrently increase utilization of the defined contribution plan.

- Require FRS members to contribute to their retirement plans.

- Consolidate employee retirement classes into two classes: regular and special risk.

- Limit Special Risk class membership to law enforcement, firefighters, and corrections officers.

- Increase the FRS vesting period from six to ten years.

- Reform the methodology used in calculating average final compensation to include only base salary, and extend the averaging period form the highest 5 years to lifetime average salary.

- Increase the normal retirement age (and minimum required years of service) to age 65 or 33 years of service for regular class members, and age 58 or 28 years of service for special risk members.

- Change the current 3% automatic COLA increase to an increase based on the current inflation rate with a 3% cap.

- Eliminate the health insurance subsidy for FRS members.

- Reform or eliminate the Deferred Retirement Option Program (DROP).

Conclusion

It seems clear that there will be a good deal of discussion and action on governmental pension issues in 2011. With the legislative session set to begin on March 8, we will be closely monitoring all pension-related legislation and other developments affecting governmental retirement programs. If you have specific questions concerning any proposal please feel free to contact us.