Milliman

1921 Gallows Road
Suite 900
Vienna, VA 22182
USA

Main +1 703 917 0143
Fax +1 703 827 9266

milliman.com

March 1, 2011

Via Overnight Delivery

Ms. Sarabeth Snuggs
State Retirement Director
Division of Retirement
1317 Winewood Boulevard, Building 8
Tallahassee, FL 32399

Re: Study Reflecting the Impact to the Florida Retirement System of Requiring 3.0% Employee Contributions of New Members Initially Enrolled on or After July 1, 2011

Dear Sarabeth:

As you requested, we have studied the impact to the Florida Retirement System of requiring all FRS members (except DROP participants) initially enrolled on or after July 1, 2011 to make employee contributions equal to 3% of covered compensation.

Background

Currently, FRS is a non-contributory plan and does not allow member contributions as a percent of compensation. Only members of the Teachers' Retirement System (TRS) and State and County Officers and Employees' Retirement System (SCOERS) pay member contributions. The proposal does not impact TRS, SCOERS, or the Institute of Food and Agricultural Sciences Supplemental Retirement Program (IFAS) since they are closed groups with no future entrants.

Assumptions and Analysis

The proposal would affect all FRS pension plan and investment plan members initially enrolled on or after July 1, 2011. FRS pension plan and investment plan members enrolled before July 1, 2011 are not affected by this proposal. The total contribution rates made to the accounts of investment plan members would be unchanged, but 3% would come from an employee initially enrolled on or after July 1, 2011 and the remainder would come from the employer, beginning in plan year 2011-2012. Under the proposal, required member contributions would not continue after a member enters DROP.

New enrollees impacted by this proposal would start to participate in the DB Plan on or after July 1, 2011. Their 3% member contribution begins on enrollment. The 2011-2012 expected employer contribution was not adjusted for new DB enrollees with their contributions of 3% of covered payroll and offsetting reduction in employer contributions as the impact for the first year is expected to be de minimus. Note the impact will grow over time as new members enter the system and are required to contribute 3% of their covered compensation.

To model the impact of the study, we re-ran the July 1, 2010 valuation for active members with the proposed employee contribution of 3% of payroll. (The proposal definition of "covered compensation" was assumed to equal valuation payroll.)

In addition, we have also included as a benefit for active members the refund of any employee contributions made by the member who terminates employment but is not eligible to retire, to receive a vested retirement allowance, or to receive a disability pension. Similarly, we have included as a benefit the refund of a decreased member's employee contributions which would be refunded to the beneficiary of a member who passed away before satisfying the eligibility for a pre-retirement death benefit. The refund does not include any interest accruals.

We analyzed the change in the Normal Cost rates to determine the impact of this prospective benefit change on future new FRS members only. The Normal Cost and Present Value of Future Normal Cost (PVFNC) in this proposal are reduced by the projected employee contributions, and are determined as though all members would make employee contributions. The Present Value of Benefits (PVB) is based on benefits expected to be paid to current active members and former members, as of July 1, 2011 and earlier. Since active members initially enrolled before July 1, 2011 will not be required to make employee contributions, the PVB is increased by the Present Value of the Future Employee Contributions used to reduce the Normal Costs that will not actually be made by current members. The actuarial accrued liability is defined as PVB less PVFNC. Thus, if PVFNC decreases and PVB increases, the actuarial accrued liability increase. Under this methodology, the immediate recognition of the lower Normal Cost and PVFNC is partially offset by the amortization of the Unfunded Actuarial Liability, which has been adjusted for active members as of July 1, 2011 who will not make employee contributions under this proposal. The PVB will decrease in future valuations as current active members are replaced by new members impacted by the change in benefits required to make employee contributions.

FRS funds the cost of DROP through a separate contribution rate paid on the salaries of current DROP participants. For purpose of this study this method was assumed to continue to apply to the adjusted rates used in analyzing these proposals. A more traditional funding of DROP would produce a different result. Note that because of the current method of funding DROP (i.e. through one separate contribution rate that applies to any DROP participant), any change in the normal cost or liabilities of any class of membership impacts the DROP contribution rate.

For purposes of this study we have made several assumptions:

- Introduction of the 3% employee contribution rate prior to DROP participation will not affect any member decisions regarding when to terminate, retire, participate in DROP, etc.

- Members who terminate after becoming vested will leave their accumulated contributions in the FRS and ultimately receive an annuity.

- The current funding technique in which the Normal Cost of each Class is based on payrolls until a member retires, terminates, begins DROP participation, etc, continues.

- Introduction of the 3% employee contribution will have no impact on PEORP elections, second elections, etc.

Results

The results for this study are shown in Table I as described below. The table details the results by class. The contribution rates are presented by class of membership and in aggregate, and reflect the increase/(decrease) in the contribution rate.

Section A of Table I includes the normal cost as of the July 1, 2010 actuarial valuation, and the impact of the proposal. In addition, the change in liability attributable to the proposal was amortized over 30 years with the payments assumed to remain relatively stable when expressed as a percentage of payroll. Section B of the table shows the change in the unfunded actuarial liability, while Section C of the table translates the estimated change in contribution rates to a reduction in dollars to be paid by employers.

As shown in Table I, the projected impact of the proposal results in a net reduction in the required contribution for fiscal year 2011-2012 to the System, although there is a projected increase in actuarial liabilities of $6.265 billion. This benefit change results in a decrease in the composite Normal Cost rate of 2.51% and an increase in the composite UAL rate of 1.29%, and therefore, an overall reduction in the composite contribution rate of 1.22%, for the System. This translates into an estimated overall employer contribution reduction of $300 million for Fiscal Year 2011-2012.

The reduction in employer costs, for each membership class, is immediately less than the 3% employee contribution because of the leakage (i.e. the possibility that a member receives a refund of his contribution), and the fact that current members will not have to contribute under this proposal. Even many years in the future when the active population is all post-June 30, 2011 enrollees, the impact will be less than 3% because of the leakage. The impact varies by class because each class has different probabilities of terminating, becoming disabled, etc., prior to attainment of vesting.

The calculations are based on data and other information provided to us by the Division of Retirement for the July 1, 2010 actuarial valuation and supplemented for purposes of this study. We have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

This analysis is based on methods and assumptions used in the July 1, 2010 actuarial valuation, and the additional assumptions discussed earlier in this letter. The data was based on the July 1, 2010 FRS actuarial valuation database. The results of our study depend on future experience conforming to those actuarial assumptions. It is certain that actual experience will not conform exactly to the assumptions used in this analysis. To the extent future experience deviates from those assumptions, the results of this analysis could vary from the results presented here.

Milliman's work product was prepared exclusively for the internal business use of Florida Department of Management Services, Division of Retirement for a specific and limited purpose. It is a complex technical analysis that assumes a high level of knowledge concerning the Florida Retirement System's operations, and uses Division data, which Milliman has not audited. To the extent that Milliman's work product is not subject to disclosure under applicable public record laws, Milliman's work may not be provided to third parties without Milliman's prior written consent. Milliman does not intend to benefit or create a legal duty to any third party recipient of its work product. Milliman's consent to release its work product to any third party may be conditioned on the third party signing a Release, subject to the following exceptions:

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No third party recipient of Milliman's work product should rely upon Milliman's work product. Such recipients should engage qualified professionals for advice appropriate to their own specific needs.

The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to the proposed plan changes. We are not attorneys and cannot give legal advice on such issues. We suggest that you review this proposal with counsel.

I, Robert Dezube, am a consulting actuary for Milliman, Inc. I am also a member of the American Academy of Actuaries, and meet their Qualification Standards to render the actuarial opinion contained herein.

Please call if you would like to further discuss this project.

Sincerely,

Milliman, Inc.

Robert

Robert S. Dezube, FSA
Consulting Actuary

Enclosure

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FLORIDA RETIREMENT SYSTEM

FISCAL IMPACT ANALYSIS

Impact of Requiring 3% Employee Contributions of New Members Initially Enrolled On or After July 1, 2011

	FRS	-----Special Risk-----		------Elected Officers' Class---			Senior	Composite		
	Regular	Regular	Administration	Judicial	Leg-Atty-Cab	County	Management	(excluding DROP)	DROP	Composite
A. Contribution Rates										
1. Present System Employer Costs (as reported the July 1, 2010 valuation - Table IV-4)										
a. Normal Cost	9.84%	22.34%	11.26%	19.42%	14.74%	16.79%	11.84%	11.81%	13.79%	11.96%
b. UAL Cost	2.23%	6.72%	25.84%	11.90%	26.72%	26.90%	12.54%	3.16%	5.78%	3.35%
c. Total Cost - FY 2012	12.07%	29.06%	37.10%	31.32%	41.46%	43.69%	24.38%	14.97%	19.57%	15.31%
2. Change in Contribution Rates due to Proposal Effective FY 2012 if Paid by Employer										
a. Normal Cost	-2.58%	-2.83%	-2.40%	-2.96%	-2.54%	-2.69%	-2.44%	-2.62%	-1.28%	-2.51%
b. Amortization of UAL Cost	1.29%	2.06%	1.04%	1.64%	1.06%	1.23%	1.09%	1.39%	0.00%	1.29%
c. Total Change in Cost	-1.29%	-0.77%	-1.36%	-1.32%	-1.48%	-1.46%	-1.35%	-1.23%	-1.28%	-1.22%
B. Additional/(Reduced) Unfunded Liability due to Proposal (000 omitted)	$4,836,361	$1,285,758	$454	$30,364	$1,215	$9,637	$101,486	$6,265,275	$0	$6,265,275
C. Additional/(Reduced) Dollars (Normal Cost and Amortization of UAL Cost) Due to Proposal to be paid by Employer for FY 2012 (000 omitted)										
1. State	($33,073)	($6,675)	($30)	($1,427)	($94)	$0	($2,661)	($43,960)	($4,982)	($48,942)
2. School Boards	($140,272)	($152)	$0	$0	$0	($133)	($785)	($141,342)	($11,884)	($153,226)
3. State Universities	$6,227	($156)	$0	$0	$0	$0	$57	$6,128	($1,307)	$4,821
4. Community Colleges	($6,025)	($13)	$0	$0	$0	$0	($322)	($6,360)	($935)	($7,295)
5. Counties	($49,677)	($19,587)	($3)	$0	$0	($466)	($2,087)	($71,820)	($6,205)	($78,025)
6. Other	($13,382)	($1,585)	($1)	$0	$0	($70)	($841)	($15,879)	($1,101)	($16,980)
7. Total	($236,202)	($28,168)	($34)	($1,427)	($94)	($669)	($6,639)	($273,233)	($26,414)	($299,647)

This work product was prepared solely for the Department of Management Services for the purposes described herein and may not be appropriate to use for other purposes. Milliman does not intend to benefit and assumes no duty or liability to other parties who receive this work.