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February 25, 2011

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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
Modifying the Definitions of "Compensation" and "Average Final Compensation" for
New Members Enrolled on or After July 1, 2011

Dear Sarabeth:

As you requested, we have studied the impact to the Florida Retirement System of "modifying the definitions for 'Average Final Compensation' and 'Compensation' for members initially enrolled on or after July 1, 2011, to exclude overtime and lump-sum annual leave payments."

Background

Currently, the FRS definition of "Average Final Compensation" includes overtime pay and accumulated annual leave payments not to exceed 500 hours. The proposal would exclude overtime and lump-sum annual leave payments from the definitions of "Compensation" and "Average Final Compensation" used to determine retirement benefits for FRS members initially enrolled on or after July 1, 2011.

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Assumptions and Analysis

The proposal would affect all future active members initially enrolled in the FRS on or after July 1, 2011. Excluding overtime and annual leave payments from the definitions of "Compensation" and "Average Final Compensation" (AFC) for future hires would provide a savings to FRS by reducing the AFC used in determining future members' benefits, and thereby reducing the monthly benefits. We used the overtime earnings included in the compensation of current actives as the basis for the overtime compensation earned by future actives.

The Division of Retirement provided data files of current actives who received overtime compensation during the plan year ending June 30, 2010. After removal of duplicates, the data included 97,195 records receiving \$283.8 million in overtime compensation. We matched these records to the active members included in the July 1, 2010 valuation. There were 76,930 matching records with a total of \$220.2 million in overtime compensation. We reduced the valuation payroll of the matching active records by the overtime compensation provided by the Division, and re-ran the July 1, 2010 valuation for active members.

The Division of Retirement compiled the overtime compensation data based on surveys submitted to all FRS agencies. The returned surveys included information on current actives who did not receive any overtime during the plan year ending June 30, 2010. Because all of the agencies did not respond, we used the actual overtime compensation reported by the responding agencies, along with the reports of no overtime paid as the basis for the overtime compensation paid by the non-responding agencies. As a proportion of total payroll, 79.32% of agencies responded. Thus, we assumed \$220.2 million in overtime compensation represented 79.32% of actual overtime compensation paid to members in the July 1, 2010 active valuation, and adjusted the results accordingly.

The 2011-2012 projected payroll used in determining the contribution rates was not adjusted for new DB enrollees as the impact is expected to be de minimus. Note the impact will grow over time as new members enter the system with the reduced compensation definition.

Currently, the valuation assumes a lump sum annual leave payout of 139 hours is credited to each retiring member to increase salary used for calculating the retirement benefits. We have removed this assumption for employees initially enrolled on and after July 1, 2011.

We determined the impact of this prospective benefit change to be the change in Normal Cost Rates. Because Normal Cost and Present Value of Future Normal Cost (PVFNC) are reduced by this proposal whereas the Present Value of Benefits (PVB) (based on benefits expected to be paid to current active members and former members, as of July 1, 2011 and earlier) is unchanged, the actuarial accrued liability is increased by this proposal. The actuarial accrued liability is defined as PVB less PVFNC. Thus, if PVFNC decreases and

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PVB remains the same, the actuarial accrued liability would increase. The PVB will decrease in future valuations as current active members are replaced by new members impacted by the change in benefits.

All current members will continue to earn benefits at levels greater than those annually earned by members initially enrolled on or after July 1, 2011. When this impact is combined with amortizing the change in the unfunded liability due to this proposal over 30 years, the funding of current member's actual normal costs will extend beyond working lifetime into retirement. Under the percent of pay amortization method used in the valuation, payment of the actual excess normal costs will effectively not occur until the last 10 years of the 30 year amortization period. Under a level percent of pay amortization, initial payments are less than interest on the unfunded liability, resulting in the unfunded liability increasing over time. After approximately 20 years, the unfunded liability will be approximately at the same level as the initial amount. By deferring to the later years of the 30-year amortization period, the funded ratio of the plan is expected to gradually decline for the next 20 years, which could compound the impact of any future adverse experience.

We assumed that the modified definition of "Compensation" and "Average Final Compensation" would not impact a future member's decision as to when to retire, or participate in DROP.

It is possible that without a corresponding decrease in the benefits in the DC Plan, a greater percentage of future hires, at hire, might initially elect DC Plan participation. This study does not address the potential impact of reducing the future enrollment in the DB Plan. This change would also impact the present calculation of transfers between the DC Plan and the DB Plan.

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 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 the actuarial liabilities of \$895 million. This benefit change results in a decrease in the composite Normal Cost rate of 0.33% and an increase in the composite

UAL rate of 0.18%, and therefore, an overall decrease in contribution levels of 0.15%, for the total composite rate for the System. This translates into an estimated overall employer contribution reduction of \$35 million for Fiscal Year 2011-2012.

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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- (b) The Division of Retirement may provide a copy of Milliman's work, in its entirety, to other Governmental entities, as required by law.



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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.

A handwritten signature in black ink that reads "Raert".

Robert S. Dezube, FSA
Consulting Actuary

Enclosures

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FLORIDA RETIREMENT SYSTEM
FISCAL IMPACT ANALYSIS

*Impact of Modifying the Definitions of "Compensation" and "Average Final Compensation"
For New Members Enrolled on or After July 1, 2011*

	FRS Regular	----Special Risk---- Regular	Administration	-----Elected Officers' Class--- Judicial	Leg-Atty-Cab	County	Senior Management	Composite (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	-0.21%	-1.09%	-0.16%	-0.25%	-0.19%	-0.22%	-0.15%	-0.34%	-0.19%	-0.33%
b. Amortization of UAL Cost	0.10%	0.81%	0.04%	0.14%	0.08%	0.09%	0.07%	0.20%	0.00%	0.18%
c. Total Change in Cost	-0.11%	-0.28%	-0.12%	-0.11%	-0.11%	-0.13%	-0.08%	-0.14%	-0.19%	-0.15%
B. Additional/(Reduced) Unfunded Liability due to Proposal (000 omitted)										
	\$378,584	\$506,544	\$25	\$2,519	\$86	\$733	\$6,115	\$894,606	\$0	\$894,606
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	(\$2,836)	(\$2,425)	(\$3)	(\$119)	(\$7)	\$0	(\$156)	(\$5,546)	(\$740)	(\$6,286)
2. School Boards	(\$11,973)	(\$55)	\$0	\$0	\$0	(\$12)	(\$47)	(\$12,087)	(\$1,764)	(\$13,851)
3. State Universities	\$393	(\$57)	\$0	\$0	\$0	\$0	\$4	\$340	(\$194)	\$146
4. Community Colleges	(\$533)	(\$4)	\$0	\$0	\$0	\$0	(\$19)	(\$556)	(\$139)	(\$695)
5. Counties	(\$4,249)	(\$7,116)	\$0	\$0	\$0	(\$42)	(\$124)	(\$11,531)	(\$921)	(\$12,452)
6. Other	(\$1,146)	(\$576)	\$0	\$0	\$0	(\$7)	(\$49)	(\$1,778)	(\$163)	(\$1,941)
7. Total	(\$20,344)	(\$10,233)	(\$3)	(\$119)	(\$7)	(\$61)	(\$391)	(\$31,158)	(\$3,921)	(\$35,079)

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