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February 22, 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 Eliminating Cost-of-Living Adjustments on Benefits Earned after June 30, 2011

Dear Sarabeth:

As you requested, we have studied the impact to the FRS of eliminating Cost-of-Living Adjustments (COLA) on benefits earned after June 30, 2011.

Background & Assumptions

Currently, the FRS provides an annual COLA equal to 3% each July 1. The proposal would eliminate future COLA increases on benefits earned after June 30, 2011[1)]. Under the proposal, current retirees would continue to receive 3% COLA increases on their benefits. Similarly, the benefits of current Terminated Vested members and members currently in DROP on June 30, 2011 would be unaffected since their entire benefits were earned before July 1, 2011. For members who are actively employed on June 30, 2011, the portion of their benefits earned prior to July 1, 2011 would receive COLA increases upon their retirement, but the portion of their benefits earned after June 30, 2011 would not receive COLA increases[1)]. Members who are initially enrolled after June 30, 2011 would receive no COLA increases on their retirement benefits.

In determining the portion of the benefit earned prior to July 1, 2011 we applied COLA to the service accrued as of June 30, 2011. For disability and death benefits with minimum benefits higher then the accrual for work performed plus situations where the 100% of average final compensation cap on retirement benefits applied, the portion attributable to benefits earned prior to July 1, 2011 was based on a ratio of service as of June 30, 2011 over total service. Note that in these situations this will result in the portion of the benefit attributable to service prior to July 1, 2011 to decline over time.

1) For purposes of this study, the benefit still subject to the annual COLA (i.e. benefit earned prior to July 1, 2011) is defined as the benefit based on creditable service as of June 30, 2011 but Average Final Compensation during the highest five plan years of Creditable Service.

To study the impact of this proposal, we re-ran the July 1, 2010 valuation for active members with additional coding that bifurcates their projected benefits. Benefits accrued before July 1, 2011 were subject to the 2010 valuation assumptions (i.e., 3% COLA); benefits accrued after June 30, 2011 were subject to the 2010 valuation assumptions, modified to eliminate COLA. The proposal reduces the Present Value of Benefits and both the Normal Cost and Present Value of Future Normal Cost.

In addition, we assumed that the change in the annual COLA would not impact a future member's decision as to when to terminate, postpone retirement, or retire with or without DROP participation, although you might expect some members to retire at later ages due to decreased benefits. Please note that the cost impact of the proposed changes may be higher or lower than the study estimates depending upon rates of retirement actually experienced in FRS. A realistic estimate of retirement rates is critical to determining the actual impact on plan costs. It is possible that a greater percentage of future hires might initially elect DC Plan participation at hire if this proposal is enacted, unless there is a corresponding decrease in DC plan contribution rates. This study does not address the potential impact of reducing 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 July 1, 2010, 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 savings to the System. The projected decrease in actuarial liabilities is $1.95 billion. The benefit change results in a decrease in the composite Normal Cost rate of 2.90% and a decrease in the composite UAL rate of 0.40%, and therefore, an overall decrease in the composite contribution rate of 3.30%, for the System. This translates into an estimated overall employer contribution savings of $892 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:

(a) The Division of Retirement may provide a copy of Milliman's work, in its entirety, to the System's professional service advisors who are subject to a duty of confidentiality and who agree to not use Milliman's work for any purpose other than to benefit the System.

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

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

Enclosures

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FLORIDA RETIREMENT SYSTEM
FISCAL IMPACT ANALYSIS

Impact of Eliminating Cost of Living Adjustments On Benefits Earned After June 30, 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	-2.44%	-5.92%	-3.17%	-4.58%	-3.62%	-4.05%	-3.08%	-2.99%	-1.82%	-2.90%
b. Amortization of UAL Cost	-0.44%	-0.36%	-1.16%	-0.37%	-0.51%	-0.49%	-0.75%	-0.43%	0.00%	-0.40%
c. Total Change in Cost	-2.88%	-6.28%	-4.33%	-4.95%	-4.13%	-4.54%	-3.83%	-3.42%	-1.82%	-3.30%
B. Additional/(Reduced) Unfunded Liability due to Proposal (000 omitted)	($1,645,871)	($226,728)	($511)	($6,902)	($578)	($3,846)	($69,972)	($1,954,408)	$0	($1,954,408)
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	($78,992)	($55,079)	($97)	($5,400)	($271)	$0	($8,749)	($148,588)	($7,084)	($155,672)
2. School Boards	($317,105)	($1,252)	$0	$0	$0	($417)	($2,125)	($320,899)	($16,898)	($337,797)
3. State Universities	($31,857)	($1,292)	$0	$0	$0	$0	($359)	($33,508)	($1,858)	($35,366)
4. Community Colleges	($19,954)	($106)	$0	$0	$0	$0	($952)	($21,012)	($1,330)	($22,342)
5. Counties	($115,200)	($161,624)	($11)	$0	$0	($1,461)	($5,642)	($283,938)	($8,823)	($292,761)
6. Other	($31,268)	($13,081)	($4)	$0	$0	($220)	($2,323)	($46,896)	($1,565)	($48,461)
7. Total	($594,376)	($232,434)	($112)	($5,400)	($271)	($2,098)	($20,150)	($854,841)	($37,558)	($892,399)

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.