**The Florida Senate**

# BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Budget Committee

BILL: SB 2100 (SPB 7094)

INTRODUCER: Budget Committee

SUBJECT: Florida Retirement System

DATE: April 1, 2011 REVISED:

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|---|---|---|---|---|
| 1. | Leadbeater | Meyer, C. | | **SPB 7094 Favorable** |
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| 3. | | | | |
| 4. | | | | |
| 5. | | | | |
| 6. | | | | |

## I. Summary:


This bill makes the following changes to the Florida Retirement System (FRS).

- Changes the name of the FRS defined benefit program to the Florida Retirement System Pension Plan (pension plan), and changes the name of the FRS defined contribution program from the Public Employee Optional Retirement Program to the Florida Retirement System Investment Plan (investment plan).
- Eliminates accumulated annual leave payments and overtime from "compensation" and "average final compensation" on or after July 1, 2011.
- Raises the normal retirement age for Special Risk Class members enrolled on or after July 1, 2011 to that of other classes if they choose to enroll in the pension plan.
- Effective July 1, 2011, closes the pension plan to new enrollees and requires compulsory enrollment in the investment plan, except that those who qualify for Special Risk Class membership may still enroll in the pension plan. Specifies that employees eligible to enroll in one of the three optional retirement programs may elect to do so in lieu of compulsory enrollment in the investment plan.
- Closes the Deferred Retirement Option Program (DROP) to new participants, effective July 1, 2011.
- Allows reenrollment after retirement in the investment plan.
- Changes vesting for members enrolled in the investment plan on or after July 1, 2011. Such members will vest in graded increments over a five-year period.

- Changes the FRS from a noncontributory system to a contributory system and requires each active member of the FRS to contribute 3 percent of pre-tax gross salary to fund retirement benefits, effective July 1, 2011.
- Eliminates the cost-of-living adjustment (COLA) for service earned on or after July 1, 2011.

The bill also includes the following provisions.

- Establishes conforming and implementing provisions related to the substantive changes to the FRS.
- Establishes the required employer payroll contribution rates for each membership class and subclass of the FRS retirement plan for the fiscal year beginning July 1, 2011.
- Requires each active member of the Senior Management Service Optional Annuity Program, the State University System Optional Retirement Program, and the Community College Optional Retirement Program to contribute the same percentage of gross salary to fund retirement benefits as those contributed by FRS employees, effective July 1, 2011.
- Allows the Department of Management Services Bureau of Local Government Retirement Funding (bureau) to use principal moneys deposited in the Police and Firefighters' Premium Tax Trust Fund to fund the bureau's operations when the interest and investment income earned on those moneys is insufficient.
- Links National Guard retiree pension benefit increases to the FRS COLA.
- Provides that during the 90-day period beginning on the effective date of the bill, a FRS employer may contribute to the retirement account of a current employee who is retired from the FRS the amount that would have been contributed had the employee been allowed to reenroll in the FRS during the 2010-2011 fiscal year.

This bill substantially amends the following sections of the Florida Statutes: 110.123, 112.0801, 112.363, 121.011, 121.021, 121.051, 121.0515, 121.052, 121.053, 121.055, 121.071, 121.081, 121.091, 121.1001, 121.101, 121.121, 121.122, 121.125, 121.35, 121.355, 121.4501, 121.4502, 121.4503, 121.571, 121.591, 121.5911, 121.70, 121.71, 121.72, 121.73, 121.74, 121.75, 121.77, 121.78, 175.121, 175.341, 185.10, 185.23, 250.22, and 1012.875.

## II. Present Situation:

### Florida Retirement System

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits to the 572,000 active and 319,000 retired members and beneficiaries of its more than 900 state and local government public employers. Originally established in 1970 as the successor to the Teachers' Retirement System and the State, and County Officers' and Employees' Retirement System, the FRS is today a combination of five previously separate pension plans. Benefit payments are administered by the Department of Management Services through its Division of Retirement while investment management is undertaken by the Board of Administration. Established as a Section 401(a) government plan under the Internal Revenue Code, its benefits are exempt from federal taxation until received by the employee.

As a defined benefit plan, the FRS "Pension Plan" provides retirement income expressed as a percent of final pay. Members accrue retirement credits based upon their eligibility in one of several membership classes. Years of creditable service multiplied by average final salary multiplied by the accrual rate for the membership class, plus up to 500 hours of annual leave, yield a monthly annuity benefit at normal retirement. The accrual rates range from 1.60 percent for the Regular Class to 3.33 percent for Justices and Judges. Members vest 100% in Pension Plan benefits upon completion of 6 years of service. For most membership classes normal retirement occurs at the earlier attainment of 30 years' service or age 62. For public safety employees in the Special Risk Retirement and Special Risk Administrative Support Classes, normal retirement is the earlier attainment of age 55 or 25 years' service. Members seeking early retirement dates receive a five percent reduction in the benefit for each year below their normal age threshold.

All membership classes in the Pension Plan permit enrollment in a Deferred Retirement Option Program (DROP) under which a participant may extend employment for an additional five years - eight years for instructional personnel in district school boards - and receive a lump sum benefit at a fixed rate of interest, currently 6.5 percent, for that additional service. Enrollment in DROP requires the participant to serve the employer with a deferred resignation from employment at the end of the period. The defined benefit plan includes a fixed, annual cost-of-living adjustment of 3 percent.

The 2000 Legislature enacted sweeping changes to the FRS by creating the Public Employees Optional Retirement Program (Part II of ch. 121, F.S.), an alternative defined contribution or "Investment Plan" for its members. While a defined benefit plan provides an annuitized monthly benefit expressed as a percent of final pay, a defined contribution plan gives members an equity interest in their employer's payroll contributions and their earnings, although it does not assure a guaranteed result. DROP enrollment is unavailable in the Investment Plan due to the incompatibility of plan designs. Members vest 100% in Investment Plan benefits upon completion of 1 year of service.

Reenrollment in the FRS is prohibited for retirees who are initially reemployed on or after July 1, 2010.

Management employees and instructional employees in higher educational units are also permitted to enroll in one of three other separate optional retirement programs that exist outside of FRS authority.

*Employer Contribution Rates*

FRS employers are responsible for contributing a set percentage of their employee's monthly compensation to the Division of Retirement to be distributed into the Florida Retirement System Contributions Clearing Trust Fund. The employer is required to make these contributions no later than the fifth working day of the month following the end of the payroll period.[1]

[1] Section 121.78, F.S.

The employer contribution rate is a "blended contribution rate" set by statute, which is the same percentage regardless of which plan their employee participates in. The rate is determined annually based on an actuarial study by the Department of Management Services that calculates the necessary level of funding to support all of the benefit obligations under both FRS retirement plans.[2] The current employer contribution rate for each membership class is:

| Membership Class | Effective July 1, 2009 | Effective July 1, 2010 |
|---|---|---|
| Regular Class | 8.69 % | 9.63 % |
| Special Risk Class | 19.76 % | 22.11 % |
| Special Risk Administrative Support Class | 11.39 % | 12.10 % |
| Elected Officer's Class | | |
| • Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders | 13.32 % | 15.20 % |
| • Justices and Judges | 18.40 % | 20.65 % |
| • County Officers | 15.37 % | 17.50 % |
| Senior Management Service Class | 11.96 % | 13.43 % |

After employer contributions are placed into the FRS Contributions Clearing Trust Fund, benefits under the Investment Plan are transferred to third-party administrators to be placed in the employee's individual investment accounts, whereas benefits under the Pension Plan are placed into the FRS Trust Fund.[3]

*Calculation of Pension Plan Benefits*

Benefits payable to a pension plan retiree are calculated using formulas that include the average final compensation. "Average final compensation" means the average of the 5 highest fiscal years of compensation for creditable service prior to retirement, termination, or death. The average final compensation includes accumulated annual leave payments, not to exceed 500 hours, and all payments defined as compensation in s. 121.021(22). The average final compensation does not include compensation paid to professional persons for special or particular services; payments for accumulated sick leave made due to retirement or termination; payments for accumulated annual leave in excess of 500 hours; bonuses as defined in s. 121.021(47); third party payments made on or after July 1, 1990; or fringe benefits such as automobile or housing allowances.[4]

"Compensation" means the monthly salary paid a member by his or her employer for work performed arising from that employment. Compensation includes overtime payments paid from a salary fund; accumulated annual leave payments; payments in addition to the employee's base

[2] Section 112.63, F.S.
[3] *See* ss. 121.4503 and 121.72, F.S.
[4] Section 121.021(24), F.S.

rate of pay if specified conditions apply; amounts withheld for tax sheltered annuities or deferred compensation programs, or any other type of salary reduction plan authorized under the Internal Revenue Code.[5]

**Optional Retirement Programs**

Eligible employees may elect to participate in one of three optional retirement programs in lieu of participation in the FRS.

Members of the Senior Management Service Class may elect to enroll in the Senior Management Service Optional Annuity Program.[6] Employees in specified positions in the State University System may elect to enroll in the State University System Optional Retirement Program.[7] Eligible employees of a community college may elect to enroll in the Community College Optional Retirement Program.[8]

**DMS Bureau of Local Government Retirement Funding**

The DMS Bureau of Local Government Retirement Funding (bureau) oversees administration of local retirement plans. It is funded by interest and investment income earned on the moneys collected for each municipality or special fire control district and deposited in the Police and Firefighters' Premium Tax Trust Fund.[9]

**National Guard Retirees**

A member or former member of the Florida National Guard who meets the specified statutory requirements may retire and receive pay in an amount equal to one-half of the base pay prescribed in the applicable pay tables for similar grades and period of service of personnel in the United States Army or Air Force.[10]

## III. Effect of Proposed Changes:

**Florida Retirement System**

*Terminology*

The bill changes the name of the FRS defined benefit program to the Florida Retirement System Pension Plan, and changes the name of the FRS defined contribution program from the Public Employee Optional Retirement Program to the Florida Retirement System Investment Plan.

[5] Section 121.021(22), F.S.
[6] Section 121.055(6), F.S.
[7] Section 121.35, F.S.
[8] Section 1012.875, F.S.
[9] Section 185.10(1), F.S.
[10] Section 250.22, F.S.

*"Compensation" and "Average Final Compensation"*

Effective July 1, 2011, the bill eliminates accumulated annual leave payments and overtime from "compensation" and "average final compensation."

*Normal Retirement Date*

The bill revises the normal retirement date for any Special Risk Class member initially enrolled in the FRS on or after July 1, 2011. Effective July 1, 2011, the bill increases the retirement age and years of service for members of the Special Risk Class and the Special Risk Administrative Support Class as follows, to align the retirement age with that of members of all other classes.:

- Increases the age from 55 to 62 years of age; and
- Increases the years of creditable service from 25 to 30

*Pension Plan Enrollment*

Effective July 1, 2011, the bill closes the pension plan to new enrollees and requires compulsory enrollment in the investment plan, except that those who qualify for Special Risk Class membership may still enroll in the pension plan.

The bill specifies that employees eligible to enroll in one of the three optional retirement programs may elect to do so in lieu of compulsory enrollment in the investment plan.

*Deferred Retirement Option Program*

Effective July 1, 2011, the bill closes DROP to new participants. However, any member entering DROP prior to that date may continue participation in DROP until completion.

*Reenrollment in the FRS*

Effective July 1, 2011, the bill allows reenrollment after retirement in the Regular Class in the FRS investment plan. Such members must meet the reemployment after retirement limitations in s. 121.091(9), F.S., and re-satisfy the vesting requirements of the investment plan. Such members are not entitled to disability benefits as provided in s. 121.091(4), F.S. or s. 121.591(2), F.S.

*Vesting of Contributions in Investment Plan*

The bill changes vesting of employer contributions for members enrolled in the investment plan on or after July 1, 2011, from 100% vesting upon completion of 1 year of service to the following schedule.

- Upon completion of 1 year of service: 20%.
- Upon completion of 2 years of service: 40%.
- Upon completion of 3 years of service: 60%.
- Upon completion of 4 years of service: 80%.
- Upon completion of 5 years of service: 100%.

Investment plan members will vest immediately in their own employee contributions.

*Employee Contributions*

The bill defines the terms “member contributions” and/or “employee contributions.” These contributions are defined as the sum of all amounts deducted from the salary of a member and credited to the member’s individual investment accounts by the employer in accordance with s. 121.72(2), F.S. The contributions also include any earnings on these amounts and any other contributions as specified.

The bill requires each member of the FRS to contribute 3 percent of his or her gross compensation to the FRS, prior to federal tax withholdings. The contribution is treated as an employer-paid employee contribution. The member must consent to the deduction as a condition of employment. A member is fully and immediately vested in all employee contributions paid to the investment plan or pension plan, plus interest and earnings thereon.

The bill specifies that if a member terminates employment for three consecutive months for any reason other than retirement, the member is eligible for a refund in the amount of his or her accumulated contributions as of the date of termination. If a member elects to receive a refund, he or she is considered to have waived all rights under the FRS and to the health insurance subsidy; however, the member does retain the right to purchase his or her prior service credit in accordance with chapter 121, F.S. The refund may not include any interest that the contributions earned, and employer contributions made on behalf of the member are not refundable. A partial refund is prohibited, and a member may not receive a refund if there is a pending or approved qualified domestic relations order filed against the member’s account.

The bill provides that a member of the pension plan who chooses to take a refund of employee contributions on or after July 1, 2011, retains his or her prior plan choice upon returning to employment with an FRS employer.

If a member chooses to switch from the pension plan to the investment plan, then a refund is not permitted for any employee contributions or additional payments which exceed the employee contributions that would have accrued had the member remained in the pension plan and not transferred to the investment plan. The same applies for a member who chooses to switch from the investment plan to the pension plan.

If a member chooses to switch retirement plans and contribution adjustments are required due to employer errors or corrections, the member is entitled to the additional contributions. However, the member is responsible for returning any excess contributions resulting from the correction. This return must be made within the period allowed by the United States Internal Revenue Service. The present value of the member’s accumulated benefit remains the same.

The bill also provides for a procedure for the repayment of an invalid refund. If a member receives an invalid refund, the member must repay the amount of the invalid refund plus 6.5 interest compounded annually on June 30 from the date of the refund until the invalid refund is fully satisfied. The invalid refund must be repaid before the member retires or transfers to the investment plan.

*Employer Contributions*

The bill also establishes employer contribution rates as follows:

| Membership Class | Effective July 1, 2011 |
|---|---|
| Regular Class | 5.09% |
| Special Risk Class | 13.80% |
| Special Risk Administrative Support Class | 6.67% |
| Elected Officer's Class<br>• Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders<br>• Justices and Judges<br>• County Officers | <br>9.46%<br>12.02%<br>11.44% |
| Senior Management Service Class | 6.88% |

The bill also provides that during the 90-day period beginning on the effective date of the bill, a FRS employer may retroactively contribute to the retirement account of a current employee who is retired from the FRS the amount that would been contributed had the employee been allowed to reenroll in the FRS during the 2010-2011 fiscal year.

*Investment Plan Disability Benefit Contributions*

The bill provides that effective July 1, 2011, allocations from the FRS Contributions Clearing Trust Fund to provide disability coverage will be the actuarially-indicated amount necessary to fund the statutorily-authorized benefit for the plan year, as determined by the state actuary. The allocations will be used to offset administrative costs for the disability benefit.

*Cost-of-Living Adjustment*

The bill eliminates the cost-of-living adjustment (COLA) for service earned on or after July 1, 2011.

**Restrictions on Payment of Benefits Before Termination**

Under the investment plan, Senior Management Service Optional Annuity Program, State University System Optional Retirement Program, or Community College System Optional Retirement program, the bill prohibits the payment of benefits before termination of employment and specifies circumstances. Benefits may not be payable for employee hardships, unforeseeable emergencies, loans, medical expenses, educational expenses, purchase of a principal residence, or any other reason prior to termination from all employment relationships with participating employers.

**Employee Contributions to Optional Retirement Programs**

The bill requires each active member of the Senior Management Service Optional Annuity Program, the State University System Optional Retirement Program, and the Community College Optional Retirement Program to contribute the same percentage of gross salary to fund retirement benefits as that contributed by FRS employees, effective July 1, 2011.

**DMS Bureau of Local Government Retirement Funding**

The bill allows the DMS Bureau of Local Government Retirement Funding (bureau) to use principal moneys deposited in the Police and Firefighters' Premium Tax Trust Fund to fund the bureau's operations when the interest and investment income earned on those moneys is insufficient.

**National Guard Retiree Benefits**

The bill provides that effective July 1, 2011, the retirement pay of a member or former member of the Florida National Guard may not be recomputed to reflect an increase in the rates of base pay for active members of the armed forces.

The bill also provides that effective July 1, 2012, and annually thereafter on July 1, the Division of Retirement shall adjust the retirement pay of National Guard retirees based on the FRS COLA.

**Miscellaneous Provisions**

The bill provides a statement of important state interest.

The bill also directs the State Board of Administration and the Department of Management Services to request a private letter ruling and determination letter from the United States Internal Revenue Service (IRS) upon the bill becoming a law. If the IRS refuses to act on the private letter ruling request, a legal opinion from a tax attorney can be substituted. It also provides that if any portion of the bill would cause the FRS to be disqualified for tax purposes under the Internal Revenue Code, then that portion of the bill would not apply. The State Board of Administration and the Department of Management Service must notify the Legislature if any portion of the bill cannot be implemented.

**Effective Date**

The bill provides an effective date of June 30, 2011, except as otherwise provided in the bill.

## IV. Constitutional Issues:

### A. Municipality/County Mandates Restrictions:

The mandates provision appears to apply because this bill requires cities and/or counties to spend money or take action that requires the expenditure of money; however, an exception applies because the Legislature has determined that this bill satisfies an important state interest. In addition, similarly-situated persons are all required to comply.

### B. Public Records/Open Meetings Issues:

None.

### C. Trust Funds Restrictions:

None.

### D. Other Constitutional Issues:

The Florida Constitution provides that any retirement or pension system supported in whole or part by public funds shall not increase benefits to the members or beneficiaries of the system after January 1, 1977, unless the provision of the funding increase is made on a sound actuarial basis.[11] The "Florida Protection of Public Employee Retirement Benefits Act" prohibits "the use of any procedure, methodology, or assumptions the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers."[12]

Provisions in the bill that create additional benefits may require an actuarial study.

## V. Fiscal Impact Statement:

### A. Tax/Fee Issues:

None.

### B. Private Sector Impact:

None.

### C. Government Sector Impact:

Actuarial studies have been performed to determine the cost savings associated with requiring a 5 percent employee contribution rate, closing DROP, closing the pension plan, changing the definition of compensation and eliminating COLA on retirement payments earned on or after July 1, 2011and increasing the normal retirement date. There is an indeterminate impact from keeping the pension plan open for special risk for those

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[11] Section 14, Art. X, Florida Constitution.
[12] Section 112.61, F.S.

who choose the pension plan over the investment plan which also requires increases normal retirement age/years for special risk if they choose the pension plans to that of other RS members. The actuary also provided figures for requiring a 3 percent employee contribution rate based upon the 5 percent contribution study. The cost savings are as follows:

| **Entities Funded by the State** | **General Revenue** | **Trust Fund** |
|---|---:|---:|
| State | $161.159 million | $145.812 million |
| County School Boards | $678.646 million | |
| Community Colleges | $46.916 million | |
| SUS | $58.116 million | |
| *Total* | *$944.837* million | $145.812 million |
| | | |

## VI. Technical Deficiencies:

None.

## VII. Related Issues:

The Legislature may wish to clarify whether retirees from an optional retirement program will be allowed to reenroll in that program, or if such retirees would become mandatory members of the FRS investment plan.

## VIII. Additional Information:

### A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

### B. Amendments:

None.