

**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 Committee on Community Affairs

---

BILL: SPB 7046

INTRODUCER: For consideration by the Community Affairs Committee

SUBJECT: Florida Retirement System

DATE: February 19, 2014

REVISED: \_\_\_\_\_

---

| ANALYST         | STAFF DIRECTOR | REFERENCE | ACTION                             |
|-----------------|----------------|-----------|------------------------------------|
| 1. <u>White</u> | <u>Yeatman</u> | <u>CA</u> | <b>Submitted as Committee Bill</b> |

---

**I. Summary:**

SPB 7046 establishes a cash balance retirement plan for Florida Retirement System (FRS) employees featuring individual employee accounts that are guaranteed a minimum retirement benefit. Cash balance plans offer some of the features of both the pension plan and the investment plan. The State Board of Administration (SBA) is responsible for administering the new plan. Cash balance accounts would be funded by employee and employer contributions based on a percentage of monthly compensation, a guaranteed 2 percent interest on the account balance, and 75 percent of any investment returns over 2 percent.

Employees hired after July 1, 2015, may choose the cash balance plan or existing investment plan, and could revise that decision by making a second election. Only special risk employees would be able to choose the pension plan. Employees under the cash balance plan are vested after completing five years of service. Existing employees may choose to move between the pension plan or investment plan to the cash balance plan. Upon retirement, employees may choose to receive the total of the cash balance account as a lump-sum distribution, direct rollover retirement account distribution, periodic distribution or combination.

**II. Present Situation:**

**The Florida Retirement System**

The FRS is the fourth largest public retirement system in the United States. It is a multi-employer, contributory plan, governed by the Florida Retirement System Act in ch. 121, F.S., and administered by the Department of Management Services (DMS).<sup>1</sup> The FRS was established in 1970 when the Legislature consolidated the Teachers' Retirement System, the State and County Officers and Employees' Retirement System, and the Highway Patrol Pension Fund. In 1972, the Judicial Retirement System was consolidated into the Pension Plan, and in 2007, the

---

<sup>1</sup> Section 121.021(5), F.S.

Institute of Food and Agricultural Sciences Supplemental Retirement Program was consolidated under the Regular Class of the FRS as a closed group.<sup>2</sup>

The FRS consists of 1,000 total employers; it is the primary retirement plan for employees of state and county government agencies, district school boards, community colleges, and universities, and also includes the 185 cities and 251 special districts that have elected to join the system.<sup>3</sup> Members of the FRS are required to make employee contributions of 3 percent of their salary.<sup>4</sup> As of June 30, 2012, the FRS had 623,011 active members, 334,682 retired members and beneficiaries, and 40,556 active members of the Deferred Retirement Option Program (DROP).<sup>5</sup>

The membership of the FRS is divided into five membership classes:

- Regular Class<sup>6</sup> consists of 535,467 active members, plus 7,675 in renewed membership;
- Special Risk Class<sup>7</sup> includes 70,005 active members;
- Special Risk Administrative Support Class<sup>8</sup> has 59 active members;
- Elected Officers' Class<sup>9</sup> has 2,005 active members, plus 201 in renewed membership; and
- Senior Management Service Class<sup>10</sup> has 7,295 members, plus 251 in renewed membership.<sup>11</sup>

Each class is funded separately based upon the costs attributable to the members of that class.

Members of the FRS have two primary plan options available for participation:

- The defined benefit plan, also known as the Pension Plan; and
- The defined contribution plan, also known as the Investment Plan.

According to information supplied by the SBA, approximately 50,000 new hires are processed each year for a retirement plan choice.<sup>12</sup> Historically, about 25 percent have actively elected the Investment Plan, 21 percent have actively elected the Pension Plan and 54 percent have defaulted into the Pension Plan.

---

<sup>2</sup> The Florida Retirement System Annual Report, July 1, 2011 – June 30, 2012, at 38, available at [https://www.rol.frs.state.fl.us/forms/2011-12\\_Annual\\_Report.pdf](https://www.rol.frs.state.fl.us/forms/2011-12_Annual_Report.pdf) (last visited Feb. 14, 2013).

<sup>3</sup> *Id.*, at 38.

<sup>4</sup> Prior to 1975, members of the FRS were required to make employee contributions of either 4 percent for Regular Class employees or 6 percent for Special Risk Class members. Employees were again required to contribute to the system after July 1, 2011.

<sup>5</sup> Florida Retirement System 2011-2012 Annual Report, at 54, 62, and 66.

<sup>6</sup> The Regular Class is for all members who are not assigned to another class. Section 121.021(12), F.S.

<sup>7</sup> The Special Risk Class is for members employed as: law enforcement officers, firefighters, correctional officers, probation officers, paramedics and emergency technicians, among others. Section 121.0515, F.S.

<sup>8</sup> The Special Risk Administrative Support Class is for a special risk member who moved or was reassigned to a nonspecial risk law enforcement, firefighting, correctional, or emergency medical care administrative support position with the same agency, or who is subsequently employed in such a position under the Florida Retirement System. Section 121.0515(8), F.S.

<sup>9</sup> The Elected Officers' Class is for elected state and county officers, and for those elected municipal or special district officers whose governing body has chosen Elected Officers' Class participation for its elected officers. Section 121.052, F.S.

<sup>10</sup> The Senior Management Service Class is for members who fill senior management level positions assigned by law to the Senior Management Service Class or authorized by law as eligible for Senior Management Service designation. Section 121.055, F.S.

<sup>11</sup> All figures from Florida Retirement System 2011-2012 Annual Report, at 55.

<sup>12</sup> It is uncertain how many of these new hires stay for their full career.

Certain members, as specified by law and position title, may, in lieu of FRS participation, participate in optional retirement plans.

#### *Investment Plan*

In 2000, the Legislature created the Public Employee Optional Retirement Program (Investment Plan), a defined contribution plan offered to eligible employees as an alternative to the FRS Pension Plan.

Benefits under the Investment Plan accrue in individual member accounts funded by both employee and employer contributions and earnings. Benefits are provided through employee-directed investments offered by approved investment providers.

A member vests immediately in all employee contributions paid to the Investment Plan.<sup>13</sup> With respect to the employer contributions, a member vests after completing one work year with an FRS employer.<sup>14</sup> Vested benefits are payable upon termination or death as a lump-sum distribution, direct rollover distribution, or periodic distribution.<sup>15</sup> The Investment Plan also provides disability coverage for both inline-of-duty and regular disability retirement benefits.<sup>16</sup> An FRS member who qualifies for disability while enrolled in the Investment Plan must apply for benefits as if the employee was a member of the Pension Plan. If approved for retirement disability benefits, the member is transferred to the Pension Plan.<sup>17</sup>

The SBA is primarily responsible for administering the Investment Plan.<sup>18</sup> The SBA is comprised of the Governor as chair, the Chief Financial Officer, and the Attorney General.<sup>19</sup> The SBA selects and contracts with a third-party administrator to provide administrative services.<sup>20</sup>

---

<sup>13</sup> Section 121.4501(6)(a), F.S.

<sup>14</sup> If a member terminates employment before vesting in the Investment Plan, the nonvested money is transferred from the member's account to the SBA for deposit and investment by the SBA in its suspense account for up to five years. If the member is not reemployed as an eligible employee within five years, then any nonvested accumulations transferred from a member's account to the SBA's suspense account are forfeited. Section 121.4501(6)(b) – (d), F.S.

<sup>15</sup> Section 121.591, F.S.

<sup>16</sup> See s. 121.4501(16), F.S.

<sup>17</sup> Pension Plan disability retirement benefits, which apply for Investment Plan members who qualify for disability, compensate an inline-of-duty disabled member up to 65 percent of the average monthly compensation as of the disability retirement date for special risk class members. Other members may receive up to 42 percent of the member's average monthly compensation for disability retirement benefits. If the disability occurs other than in the line of duty, the monthly benefit may not be less than 25 percent of the average monthly compensation as of the disability retirement date. Section 121.091(4)(f), F.S.

<sup>18</sup> Section 121.4501(8), F.S.

<sup>19</sup> Section 4, Art. IV, Fla. Const.

<sup>20</sup> The third-party administrator may not be a provider or be affiliated with a provider. Section 121.4501(8)(a), F.S.

*Pension Plan*

The Pension Plan is administered by the secretary of the DMS through the Division of Retirement.<sup>21</sup> Investment management is handled by the SBA. As of July 1, 2013, the actuarial funding level of the plan was at 85.9 percent, the lowest it has been since 1997.<sup>22</sup>

Any member initially enrolled in the Pension Plan before July 1, 2011, vests in the Pension Plan after completing six years of service with an FRS employer.<sup>23</sup> For members enrolled on or after July 1, 2011, the member vests in the Pension Plan after eight years of creditable service.<sup>24</sup> Benefits payable under the Pension Plan are calculated based on years of service x accrual rate x average final compensation.<sup>25</sup> For most members of the Pension Plan, normal retirement occurs at the earliest attainment of 30 years of service or age 62.<sup>26</sup> For public safety employees in the Special Risk and Special Risk Administrative Support Classes, normal retirement is the earliest of 25 years of service or age 55.<sup>27</sup> Members initially enrolled in the Pension Plan on or after July 1, 2011, have longer vesting requirements. For members initially enrolled after that date, the member must complete 33 years of service or attain age 65, and members in the Special Risk classes must complete 30 years of service or attain age 60.<sup>28</sup>

*Contribution Rates*

FRS employers are responsible for contributing a set percentage of the member's monthly compensation to the Division of Retirement to be distributed into the FRS Contributions Clearing Trust Fund. The employer contribution rate is a blended contribution rate set by statute, which is the same percentage regardless of whether the member participates in the Pension Plan or the Investment Plan.<sup>29</sup> In order to address unfunded actuarial liabilities (UAL) of the system, an employer contribution rate is set in statute. The rates are determined annually based on an actuarial study obtained by the DMS that calculates the necessary level of funding to support all of the benefit obligations under both FRS retirement plans.

---

<sup>21</sup> Section 121.025, F.S.

<sup>22</sup> Presentation to House Committee on Appropriations by Heather Williamson, Staff Director for the House Committee on Government Operations, (Feb. 12, 2014).

<sup>23</sup> Section 121.021(45)(a), F.S.

<sup>24</sup> Section 121.021(45)(b), F.S.

<sup>25</sup> Section 121.091, F.S.

<sup>26</sup> Section 121.021(29)(a)1., F.S.

<sup>27</sup> Section 121.021(29)(b)1., F.S.

<sup>28</sup> Sections 121.021(29)(a)2. and (b)2., F.S.

<sup>29</sup> Section 121.70(1), F.S.

**Table 1. Current Employer Contribution Rates for Each Class:**<sup>30</sup>

| Membership Class   | Normal Cost        |               | UAL Rate           |               |
|--|--------------------|---------------|--------------------|---------------|
|  | Effective 7/1/2013 | Yearly Change | Effective 7/1/2013 | Yearly Change |
| Regular Class  | 3.53%              | -0.02%        | 2.19%              | 1.70%         |
| Special Risk Class   | 11.00%             | -0.01%        | 6.83%              | 4.08%         |
| Special Risk Administrative Support Class  | 4.17%              | 0.23%         | 30.56%             | 29.73%        |
| Elected Officer’s Class  |                    |               |                    |               |
| • Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders | 6.52%              | -0.01         | 24.85%             | 23.97%        |
| • Justices and Judges  | 10.05%             | 0.03%         | 17.00%             | 16.23%        |
| • County Officers  | 8.44%              | 0.08%         | 23.36%             | 22.63%        |
| Senior Management Service Class  | 4.81%              | -0.03%        | 12.27%             | 11.95%        |
| Deferred Retirement Option Program (DROP)  | 4.63%              | 0.30%         | 7.01%              | 7.01%         |

For all membership classes, except the DROP, employees contribute 3 percent of their compensation towards retirement.<sup>31</sup>

After employer and employee contributions are placed into the FRS Contributions Clearing Trust Fund, the allocations under the Investment Plan are transferred to third-party administrators to be placed in the employee’s individual investment accounts, whereas contributions under the Pension Plan are transferred into the FRS Trust Fund.<sup>32</sup>

*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 five or eight highest fiscal years of compensation for creditable service prior to retirement, termination, or death. If you enrolled in FRS prior to July 1, 2011, your average final compensation will be five years. If you enrolled in FRS on or after July 1, 2011, your average final compensation will be eight years. 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.<sup>33</sup>

<sup>30</sup> Section 121.71(4)-(5), F.S.

<sup>31</sup> Section 121.71(3), F.S.

<sup>32</sup> See sections 121.4503 and 121.72(1), F.S.

<sup>33</sup> Section 121.021(24), F.S.

“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 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.<sup>34</sup>

### Cash Balance Plans

According to the U.S. Department of Labor, a cash balance plan is “a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan.”<sup>35</sup> Specifically, the promised benefit may be defined in terms of a stated account balance. However, per Internal Revenue Service (IRS) Code, the benefit must be “definitely determinable,”<sup>36</sup> such as is the case with conversion of the account balance into a monthly annuity.<sup>37</sup> Cash balance plans, typically:<sup>38</sup>

- Provide each member with an individual account;
- Are funded through both employee and employer contributions into one trust fund;
- Relieve members from making choices about how the money is invested;
- Guarantee members a return on investment;
- Place investment risks solely on the employer;
- Provide member accounts with dividends when investment returns exceed a threshold;
- Offer a retiring member an annuity based on their account balance;
- Offer a lump sum distribution that can be rolled into an IRA or another employer's plan; and
- Protect benefits through federal insurance provided by the Pension Benefit Guaranty Corporation.

Although “notional” or “hypothetical” account balances accrue for each employee, plan assets are not segregated into individual accounts.<sup>39</sup> Plan sponsors invest the assets of the plan collectively, just like those of any other defined benefit plan, so the combined value of participant accounts typically will not equal the total value of plan assets. However, participants’ benefits are guaranteed because of an obligation that the employer fund any shortfall in accumulated assets below the accrued liabilities of the plan.

---

<sup>34</sup> Section 121.021(22), F.S.

<sup>35</sup> Cash balance plans are one of a variety of “hybrid” plans. U.S. Department of Labor, *FAQs About Cash Balance Pension Plans*, [http://www.dol.gov/ebsa/FAQs/faq\\_consumer\\_cashbalanceplans.html](http://www.dol.gov/ebsa/FAQs/faq_consumer_cashbalanceplans.html) (last visited Feb. 12, 2014).

<sup>36</sup> IRS Code, section 401(a)(25) states that a defined benefit plan is treated as providing definitely determinable benefits so long as any assumptions that are used to determine a benefit under the plan are specified in the plan in a manner that precludes employer discretion.

<sup>37</sup> IRS Code, sections 411(a)(7)(A)(i) and 411(b)(2)(B) indicate that the fundamental definition of the accrued benefit under a defined benefit plan is in the form of an annuity beginning at normal retirement age. Code section 411(c)(3) and Notice 96-8 clarify that the requirements of Code section 411 are to be applied on the basis of a life annuity.

<sup>38</sup> U.S. Dep’t of Labor, *supra* note 35.

<sup>39</sup> National Association of State Retirement Administrators, *Issue Brief: State Hybrid Retirement Plans* (Sep. 2013), available at [http://www.nasra.org/files/Issue Briefs/NASRAHybridBrief.pdf](http://www.nasra.org/files/Issue%20Briefs/NASRAHybridBrief.pdf) (last visited Feb. 14, 2014).

*Risk Allocation, as Compared with Investment and Pension Plans*

As a hybrid plan, a cash balance plan apportions risk between employees and employers differently than in a pure defined contribution plan, or a defined benefit plan. Risk within retirement systems can be expressed in terms of investment risk, accessibility risk, longevity risk, and inflation risk.<sup>40</sup>

In a cash balance system, employers bear the investment risks associated with meeting the minimum guaranteed return rate. Because assets are pooled and invested by professionals and specified annual returns are provided on notional participant accounts, employees do not bear investment risks associated with having the sophistication to manage investments, as is the case with a pure defined contribution plan.

If the vesting period is not attained by an employee in a traditional defined benefit plan, that employee foregoes access to employer contributions. Cash balance plans are typically designed with vesting that occurs either immediately or within a couple of years.<sup>41</sup> Additionally, they are designed to offer portability to other retirement systems, much like in a defined contribution plan. Cash balance plans, with their typically short vesting periods and greater portability of funds, ensure retirement funds are accessible to employees who may work for a variety of employers over the course of their careers.

Longevity risk refers to the risks associated with an employee outliving their retirement benefits.<sup>42</sup> In a pure defined contribution system that provides one lump-sum amount to employees, longevity risk falls on employees, individually, who must ensure funds are not exhausted over their retired life. Both traditional defined benefit plans and cash balance plans offer payment of an employee's benefit in the form of a series of payments for life to begin at retirement. By requiring participants to receive all or most of their benefit as an annuity paid out over their retired lifetime, longevity risk is pooled across plan participants, but the employer bears the risk that plan assets are sufficient to cover all distributions.

Inflation risk refers to potential losses incurred due to the devaluation of money over time. Reducing inflation risk for post-retirement years typically requires an employee to have saved enough to offset future price increases. Alternatively, many public defined benefit plans provide retirees with an annual cost-of-living adjustment (COLA) to offset the effects of inflation. A COLA places some of the inflation risk on the employer. Defined contribution plans generally do not offer postretirement adjustments, so the employee assumes all inflationary risk. A cash balance plan can be designed that provides an optional COLA on the annuitized benefits.<sup>43</sup>

---

<sup>40</sup> For a more detailed discussion of the investment risk, longevity risk, and inflation risk associated with various hybrid plans, see NASRA, *State Hybrid Retirement Plans Part II: Shared-Risk Arrangements* (Aug. 2012), available at <http://www.nasra.org/files/Issue%20Briefs/NASRAHybridIIBrief.pdf> (last visited Feb. 15, 2014).

<sup>41</sup> Private employers offering cash balance plans must offer vesting within 3 years pursuant to ERISA and other federal laws.

<sup>42</sup> NASRA, *supra* note 40.

<sup>43</sup> NASRA, *Issue Brief: Cost of Living Adjustments* (June 2012), <http://www.nasra.org/resources/COLA%20IB%20060512.pdf> (last visited Feb. 15, 2014).

### *Cash Balance Plans in Other States*

Legislatures in 5 states have sought to reduce the fiscal burden of unfunded pension promises made to current and retired government employees by passing legislation that implements some form of cash balance plan.<sup>44</sup> While designs of these cash balance plans vary with respect to contributions, benefit accrual rates, vesting periods, and benefit payments, they all offer “fully funded retirement benefits, access to professionally managed, low-fee, pooled investments with appropriate asset allocations,” and access to annuities.<sup>45</sup> The statewide retirement systems that are designed as cash balance plans are:

- California State Teachers Retirement System (for part-time workers);<sup>46</sup>
- Kansas Public Employees Retirement System (effective 1/1/15);<sup>47</sup>
- Kentucky Public Employees Retirement System (effective 1/1/14);<sup>48</sup>
- Nebraska Public Employees' Retirement System (for state and county workers);<sup>49</sup>
- Texas County & District Retirement System;<sup>50</sup>
- Texas Municipal Retirement System.<sup>51</sup>

---

<sup>44</sup> See Table 2, *infra*, for a comparison of these plans.

<sup>45</sup> The Pew Charitable Trusts, *Public Pension Cash Balance Plans: A Primer* (Feb. 2014), available at [http://www.pewstates.org/uploadedFiles/PCS\\_Assets/2014/CashBalance-Brief\\_v7.pdf](http://www.pewstates.org/uploadedFiles/PCS_Assets/2014/CashBalance-Brief_v7.pdf) (last visited Feb. 14, 2013).

<sup>46</sup> California State Teachers' Retirement System, *Overview of the California State Teachers' Retirement System and Related Issues* (2013), available at [http://www.calstrs.com/sites/main/files/file-attachments/overview\\_2013\\_v2.pdf](http://www.calstrs.com/sites/main/files/file-attachments/overview_2013_v2.pdf).

<sup>47</sup> Kansas Legislature, Bill Summary for HB 2333: New Tier 3 Cash Balance Plan (2012), available at [http://www.kslegislature.org/li\\_2012/b2011\\_12/measures/documents/summary\\_hb\\_2333\\_2012.pdf](http://www.kslegislature.org/li_2012/b2011_12/measures/documents/summary_hb_2333_2012.pdf).

<sup>48</sup> Kentucky Legislature, *Senate Bill 2* (2011), available at <http://www.lrc.ky.gov/record/11rs/SB2.htm>.

<sup>49</sup> Nebraska Public Employees Retirement Systems, *Annual Report to the Legislative Retirement Committee* (2013), available at [http://nebraskalegislature.gov/FloorDocs/103/PDF/Agencies/Retirement\\_Plans\\_\\_Administrator\\_of/410\\_20130422-144332.pdf](http://nebraskalegislature.gov/FloorDocs/103/PDF/Agencies/Retirement_Plans__Administrator_of/410_20130422-144332.pdf).

<sup>50</sup> Texas County and District Retirement System, *Guide to Member Benefits*, available at <https://www.tcdrs.org/TCDRS%20Publications/GuidetoMemberBenefits.pdf>.

<sup>51</sup> Texas Municipal Retirement System, *TMRS Facts* (2013), available at [http://www.tmr.org/down/pubs/TMRS\\_Facts\\_2012\\_web.pdf](http://www.tmr.org/down/pubs/TMRS_Facts_2012_web.pdf).



**Table 2. Comparison of Cash Balance Plans in 5 States<sup>52</sup>**

|                                    | Employee Contribution                                | Employer Contribution                                  | Guaranteed Return   | Dividends  | Vesting Schedule                                 | Benefit Payment  |
|------------------------------------|--|--|---|--|--|--|
| California                         | 4%   | 4%   | Based on the average of 30-year U.S. Treasury bonds.                          | Granted, if plan funding ratio > 100%; depends on Treasury bond rates. | Immediate  | Lump-sum and/or monthly lifetime annuity or period certain monthly annuity   |
| Kansas                             | 6%   | 3 to 6% based on tenure                                | 5.25%   | Possible   | 5 years  | Lump-sum up to 30%, annuity, and participants may elect to fund an auto-COLA   |
| Kentucky                           | 5% for regular members, 8% for public safety members | 4% for regular members, 7.5% for public safety members | 4%  | 75% of long-run (five-year average) returns above the guarantee        | 5 years  | Annuity payments, optional payment of the equivalent of life annuity, or refund of account balance                   |
| Nebraska                           | 4.5% for county members, 4.8% for state members      | 6.8% for county members, 7.5% for state members        | Greater of 5%, or the federal mid-term rate plus 1.5%                         | Granted depending on the plan's funding level and board approval       | 3 years  | Annuity of any portion of the cash balance with option for automatic annual COLA. Lump sum of any remainder          |
| Texas (County and District System) | 4 to 7% depending on employer election               | Between 100 and 250% of the member's contribution      | 7%  | None provided  | 5, 8, or 10 years depending on employer election | Lifetime annuity based on employee final account balance, less any partial lump sum payments, plus employer matching |
| Texas (Texas Municipal System)     | 5 to 7% depending on employer election               | Between 100 and 200% of the member's contribution      | 5% member contributions. Employer contributions earn annual return on assets. | Granted upon board approval  | 5, 8, or 10 years depending on employer election | Annuity with partial lump sum option   |

<sup>52</sup> NASRA, *Issue Brief: State Hybrid Retirement Plans* (Sep. 2013), available at <http://www.nasra.org/files/Issue%20Briefs/NASRAHybridBrief.pdf>; The Pew Charitable Trusts, *Public Pension Cash Balance Plans* (Feb. 2014), available at [http://www.pewstates.org/uploadedFiles/PCS\\_Assets/2014/CashBalance-Brief\\_v7.pdf](http://www.pewstates.org/uploadedFiles/PCS_Assets/2014/CashBalance-Brief_v7.pdf); NASRA, *DC, Cash Balance, and Hybrid Plans*, available at <http://www.nasra.org/Files/Topical%20Reports/Governance%20and%20Legislation/Pension%20Reform/dcplans.pdf> (last visited Feb. 15, 2014).

### III. Effect of Proposed Changes:

**Section 1** directs the Division of Law Revision and Information to designate portions of ch. 121, F.S., as parts III and IV of the chapter, and to create a new part III of ch. 121, F.S., to be entitled the “Florida Retirement System Cash Balance Plan.”

**Section 2** creates s. 121.601, F.S., to provide definitions applicable to the new FRS cash balance plan. The key definitions include “active member,” “annuity savings account,” “approved provider,” “eligible employee,” “retirement annuity account,” and “vested.”

An “active member” is a member actively employed by a participating employer. “Annuity savings account” means the account containing the member contributions. An “approved provider” is a private sector company selected and approved by the SBA to offer annuity products. “Retirement annuity account” means the account containing the employer contributions. A member is deemed to be “vested” upon completing 5 years of creditable service in the FRS.

**Section 3** creates s. 121.602, F.S., which establishes the cash balance plan within the FRS, to be administered by the SBA as a qualified governmental plan under s. 401(a) of the Internal Revenue Code. The cash balance plan references certain provisions of the investment plan, especially with respect to administration of accounts, while being a completely distinct plan. It is designed as follows:

#### *Participation by Special Risk Class*

Employees initially hired on or after July 1, 2015, and eligible to participate in the Special Risk Class, may choose to participate in either the pension plan, the investment plan or the cash balance plan. A special risk employee has eight months to make the election, and participation in their elected plan is retroactive to the first day of employment. If the employee fails to make an election after the eighth month, the employee will be placed in the investment plan. After the eight month time period for making an election, an employee has one additional opportunity to elect participation in another plan, including the pension plan.

#### *Participation, Generally*

Employees initially hired on or after July 1, 2015, and not eligible to participate in the Special Risk Class, must choose either the investment plan or the cash balance plan. An employee has eight months to make their initial election, and participation in their elected plan is retroactive to the first day of employment. If any employee fails to make an active election to participate in a plan by the end of the eighth month following the employee’s month of hire, the member will be enrolled in the investment plan. After the eight month time period for making an election, an employee has one additional opportunity to elect participation in either the investment or cash balance plan.

#### *Single Election Option*

All active members of the pension plan or investment plan are granted one career-time election to transfer to the cash balance plan. If this election is used, the transfer is final and irrevocable. If the member transfers to the cash balance plan, the member may either retain his service credits

or accumulations in the prior plan or transfer the amounts to the cash balance plan. Any transfer to the cash balance plan is treated as an employer credit within the cash balance plan.

#### *Contributions*

The member and employer will make monthly contributions to the active member's cash balance accounts based on a percentage of the member's gross monthly compensation. No voluntary contributions may be made into the cash balance plan. The SBA has a duty to ensure that plan assets are held in trust and allocated properly. The DMS is responsible for monitoring contribution levels for the cash balance plan.

Section 121.721, F.S., is created (by section 17 of the bill) which sets the contributions paid by employers and members for the cash balance plan. All active members will pay 3 percent of their gross monthly compensation to the plan. The employer contributions for retirement benefits will vary based on the class in which the member participates. The accounts will be credited with a guaranteed 2 percent annual effective rate. If the cash balance plan portfolio earns more than 2 percent return during the prior year, the members will be credited 75 percent of the rate over 2 percent. The guaranteed interest is credited monthly and the additional interest is credited annually. Members are not eligible for any interest credits if the member has taken a full distribution or annuitized the account balance prior to the posting of the interest credits.

#### *Accounts*

Member contributions and the associated interest are credited to the annuity savings account. The employer contributions and associated interest are credited to the retirement annuity account.

#### *Vesting*

The member is immediately vested in all member contributions and associated interest paid into the annuity savings account. The member becomes vested in the employer contributions, employer credits and associated interest paid into the retirement annuity account upon completion of 5 years of creditable service in the FRS. If the member transfers any credit from the investment plan or the pension plan, the member must meet the applicable vesting requirements of those plans prior to vesting in those amounts transferred to the cash balance plan. If a non-vested member is reemployed within 15 years of termination and has not withdrawn the employee contributions, then the prior earned employer contributions will be restored.

#### *Benefit Payments*

Benefits may not be paid from cash balance plan accounts, unless the member has terminated employment or is deceased. To receive benefits, a member must submit a written application. The benefits are payable as a lump-sum distribution, an eligible rollover distribution, an annuity or a combination of the three methods. The benefit payment method selected by the member is final and irrevocable once the benefit payment is cashed, transferred or deposited. No benefits are payable from the cash balance plan for hardships, loans, unforeseeable emergencies or any other purpose other than retirement. The SBA may cash out a de minimis account (\$5,000 or less) of a member who has terminated employment for a minimum of six calendar months. An employee may not receive a distribution if a qualified domestic relations order is filed against the member's cash balance account.

*Disability Payments*

If a member of the cash balance plan becomes totally and permanently disabled, the member may elect to receive the vested balance of the member's cash balance accounts or may transfer such balances to the pension fund to be eligible to receive a disability benefit from the pension fund. Employers participating in the FRS will be assessed an amount to pay for the disability benefits.

*Death Benefits*

If a member of the cash balance plan dies prior to retirement, a beneficiary may receive benefits as if the member retired on the date of death. The benefits may be payable as a lump-sum distribution, an eligible rollover distribution, an annuity, or a combination of the three. If a member of the cash balance plan is killed in the line of duty, the surviving spouse may transfer the benefits to the pension fund and receive a monthly lifetime benefit equal to one half of the member's monthly salary at the time of the member's death.

*Designation of Beneficiaries*

Members of the cash balance plan may designate beneficiaries similar to the way members of the investment plan designate beneficiaries.

*Purchase of Creditable Military Service*

Members of the cash balance plan may purchase certain military service and up to two years of other service based on authorized leaves of absence granted by employers participating in the FRS, pursuant to s. 121.111(1), F.S. No other service may be purchased.

*Retiree Health Insurance Subsidy*

Members of the cash balance plan are eligible to accrue benefits under the retiree health insurance subsidy program administered pursuant to s. 112.363, F.S.

*Social Security Coverage*

Members of the cash balance plan will be provided social security coverage similar to other members of the FRS.

*Cash Balance Plan Education*

The SBA is required to provide an education component for the members of the cash balance plan similar to the education component offered to the members of the investment plan.

*Member Information Requirements*

The SBA is required to provide quarterly benefit statements to the members of the cash balance plan.

*Federal Requirements*

The cash balance plan must be administered in compliance with federal requirements, to maintain its status as a qualified governmental plan. The SBA is granted rulemaking authority necessary to maintain such compliance. Credits payable under the cash balance plan may not exceed the maximum amount permitted under s. 401(a) of the Internal Revenue Code.

*Cash Balance Plan Administration*

The cash balance plan will be administered by the SBA similar to how the investment plan is administered.

*Fiduciary Standards and Responsibilities*

Investment of the cash balance plan assets will be made for the sole interest of the members and beneficiaries of the plan and to defray the expenses of administering the plan.

*Annual Actuarial Study*

An actuarial valuation of the cash balance plan must be completed annually by the SBA.

*Recommendations by Investment Advisory Council*

The Investment Advisory Council is charged with making recommendations to the SBA regarding investment policy, strategy and procedures for the cash balance plan.

*Investment Policy Statement*

The SBA will invest the funds in the cash balance plan. These investments must comply with the investment policy statement approved by the Trustees of the SBA.

**Section 4** amends s. 112.363, F.S., to establish that a member of the cash balance plan may begin receiving the retiree health insurance subsidy upon retirement.

**Sections 5 and 6** amend s. 121.011-012, F.S., to update references to part IV of ch. 121, F.S.

**Section 7** amends s. 121.021, F.S., to add “cash balance program” to the definition of FRS.

**Section 8** amends s. 121.051, F.S., to establish the retirement plan options available to employees eligible to participate in the Community College Optional Retirement Program (CCORP). Employees hired on or after July 1, 2015, may choose to participate in the CCORP, the investment plan or the cash balance plan. Existing members of CCORP are not permitted to transfer to the pension plan after July 1, 2015.

**Section 9** amends s. 121.052, F.S., to eliminate the option for members eligible for the Elected Officers Class to choose to participate in the Senior Management Service Class.

**Section 10** amends s. 121.055, F.S., to eliminate the option for members eligible for the Elected Officers Class to choose to participate in the Senior Management Service Class or the Senior Management Service Optional Annuity Program (SMSOAP). The SMSOAP is closed to new members effective July 1, 2015. Members enrolled in the SMSOAP prior to July 1, 2015, may retain membership in the program.

**Section 11** amends s. 121.091, F.S., to apply current reemployment restrictions to the retirees of the cash balance plan. After retirement in the cash balance plan, a retiree may not be reemployed with an FRS-participating employer within the first six calendar months of retirement.

**Section 12** amends s. 121.151, F.S., to authorize the SBA to invest the assets of the cash balance plan.

**Section 13** amends s. 121.35, F.S., to allow employees eligible to participate in the State University System Optional Retirement Program (SUSORP) and initially employed on or after July 1, 2015, the opportunity to choose to participate in the SUSORP, the investment plan or the cash balance plan.

**Section 14** amends s. 121.4501, F.S., to allow each member enrolled in the FRS prior to July 1, 2015, one opportunity during the member's active career to switch from the pension plan to the cash balance plan or from the investment plan to the cash balance plan.

**Section 15** amends s. 121.70, F.S., to make clarifying changes so that the cash balance plan is recognized as a component of the FRS.

**Section 16** amends s. 121.71, F.S., to continue the blended rate methodology, so that the costs associated with the pension plan, the investment plan and the cash balance plan are included for actuarial valuation purposes.

**Section 17** creates s. 121.721, F.S., to set the contributions paid by employers and members for the cash balance plan. All active members will pay 3 percent of their gross monthly compensation to the plan. The employer contributions for retirement benefits will vary based on the class in which the member participates. The accounts will be credited with a guaranteed 2 percent annual effective rate. If the cash balance plan portfolio earns more than 2 percent return during the prior year, the members will be credited 75 percent of the rate over 2 percent. The guaranteed interest is credited monthly and the additional interest is credited annually. Members are not eligible for any interest credits if the member has taken a full distribution or annuitized the account balance prior to the posting of the interest credits.

This section also establishes the methodology for the crediting of interest to the member accounts.

**Section 18** amends s. 121.73, F.S., to set the employer contributions required to fund the disability and death benefits provided under the cash balance plan. At this time these rates are based on the similar benefits cost decrements identified in the 2013 FRS Valuation of the pension plan.

**Section 19** amends s. 121.74, F.S., to permit the education and administrative assessment paid by employers to be used by the SBA for both the investment plan and the cash balance plans.

**Section 21** amends s. 121.78, F.S., to establish the usage of penalties and delinquent fees relating to cash balance plan contributions.

**Section 22** amends s. 216.136, F.S., to expand the responsibilities of the FRS Actuarial Assumption Conference to include developing official information relating to the FRS cash balance plan.

**Sections 20, 23, and 24** amend s. 121.76, 238.072, and 413.051, F.S., to make technical changes to conform, to correct cross-references, or to make other technical changes.

**Section 25** provides a legislative statement that this bill fulfills an important state interest.

**Section 26** adjusts the contributions paid by FRS-participating employers to fund the provisions of this act.

**Section 27** directs the SBA to seek a determination letter from the IRS regarding the changes to the FRS made by this bill.

**Section 28** provides that the bill is effective July 1, 2015.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

Because the FRS is a multi-employer pension plan, the effects of this bill extend to all member FRS government employers. To the extent this bill requires cities and counties to spend money or take action that requires the expenditure of money, the mandates provision of Art. VII, s. 18 of the State Constitution may apply. If those constitutional provisions do apply, in order for the law to be binding upon the cities and counties, the Legislature must find that the law fulfills an important state interest (included in section 25 of the bill), and one of the following relevant exceptions must be met:

- Funds estimated at the time of enactment sufficient to fund such expenditures are appropriated;
- Counties and cities are authorized to enact a funding source not available for such local government on February 1, 1989, that can be used to generate the amount of funds necessary to fund the expenditures;
- The expenditure is required to comply with a law that applies to all persons similarly situated; or
- The law must be approved by two-thirds of the membership of each house of the Legislature.

This bill contains a statement indicating that the bill fulfills an important state interest and the bill applies to similarly situated persons (all employers who participate in the FRS), so it appears that this exception would apply.

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

None.

##### **C. Trust Funds Restrictions:**

None.

D. Other Constitutional Issues:

**Actuarial Requirements**

Article X, s. 14 of the State Constitution requires that benefit improvements under public pension plans in the State of Florida be concurrently funded on a sound actuarial basis, as set forth below:

SECTION 14. State retirement systems benefit changes.--A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not after January 1, 1977, provide any increase in the benefits to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis.

Article X, s. 14 of the State Constitution is implemented by statute under part VII of ch. 112, F.S., the “Florida Protection of Public Employee Retirement Benefits Act” (Act). The Act establishes minimum standards for the operation and funding of public employee retirement systems and plans in the State of Florida. It 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.

The DMS has commissioned an actuarial study to determine the overall fiscal impacts of the cash balance plan.

**Contractual Obligations**

Article I, s. 10 of the State Constitution prohibits any bill of attainder, ex post facto law, or law impairing the obligation of contracts from being passed by the Florida Legislature.

The Florida Statutes provide that the rights of members of the FRS are of a contractual nature, entered into between the member and the state, and such rights are legally enforceable as valid contractual rights and may not be abridged in any way.<sup>53</sup> This “preservation of rights” provision<sup>54</sup> was established by the Florida Legislature with an effective date of July 1, 1974.

The Florida Supreme Court has held that the Florida Legislature may only alter the benefits structure of the FRS prospectively.<sup>55</sup> The prospective application would only alter future benefits. Those benefits previously earned or accrued by the member, under the previous benefit structure, remain untouched and the member continues to enjoy that

---

<sup>53</sup> Section 121.011(3)(d), F.S.

<sup>54</sup> The “preservation of rights” provision vests all rights and benefits already earned under the present retirement plan so the Legislature may now only alter the benefits prospectively. *Florida Sheriffs Association v. Department of Administration, Division of Retirement*, 408 So. 2d 1033, 1037 (Fla. 1981).

<sup>55</sup> *Id.* at 1035.



level of benefit for the period of time up until the effective date of the proposed changes. Further, once the participating member reaches retirement status, the benefits under the terms of the FRS in effect at the time of the member's retirement vest.<sup>56</sup>

The Florida Supreme Court further held that the "preservation of rights" provision was not intended to bind future legislatures from prospectively altering benefits which accrue for future state service.<sup>57</sup> More recently, the Florida Supreme Court reaffirmed the previous holding, finding that the Legislature can alter the terms of the FRS, so long as the changes to the FRS are prospective.<sup>58</sup>

This bill does not change any benefits that a member earned prior to July 1, 2015.

## **V. Fiscal Impact Statement:**

### **A. Tax/Fee Issues:**

The bill will pass along to all employer members of the FRS an adjustment to their statutory payroll costs in order to fund the proposed benefit changes. The amount of this change will not be known until the actuarial studies are completed.

### **B. Private Sector Impact:**

None.

### **C. Government Sector Impact:**

A number of the provisions of the bill will require actuarial studies to determine the fiscal impact on the FRS.

The SBA will also incur costs to establish the cash balance plan. No estimate is currently available.

## **VI. Technical Deficiencies:**

None.

## **VII. Related Issues:**

None.

## **VIII. Statutes Affected:**

This bill substantially amends the following sections of the Florida Statutes: 112.363, 121.011-012, 121.021, 121.051, 121.052, 121.055, 121.091, 121.151, 121.35, 121.4501, 121.70-71, 121.73-74, 121.76, 121.78, 213.136, 238.072, and 413.051.

---

<sup>56</sup> *Id.* at 1036.

<sup>57</sup> *Id.* at 1037.

<sup>58</sup> *Rick Scott, et al. v. George Williams, et al.*, 107 So. 3d 379 (Fla. 2013).

This bill creates sections 121.601, 121.602, and 121.721 of the Florida Statutes.

**IX. Additional Information:**

**A. Committee Substitute – Statement of Changes:**

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

None.

**B. Amendments:**

None.

---

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

---