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**DATE:** March 22, 2001

**HOUSE OF REPRESENTATIVES  
AS REVISED BY THE COMMITTEE ON  
FISCAL POLICY & RESOURCES  
ANALYSIS**

**BILL #:** HB 347

**RELATING TO:** Public Employees Optional Retirement Program

**SPONSOR(S):** Representative(s) Fasano

**TIED BILL(S):** HB 503 (creates Public Employees Optional Retirement Program Trust Fund)

**ORIGINATING COMMITTEE(S)/COUNCIL(S)/COMMITTEE(S) OF REFERENCE:**

- (1) STATE ADMINISTRATION YEAS 6 NAYS 0
  - (2) FISCAL POLICY & RESOURCES
  - (3) FISCAL RESPONSIBILITY COUNCIL
  - (4)
  - (5)
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**I. SUMMARY:**

Chapter 2000-169, Laws of Florida, directed the Trustees of the State Board of Administration (the Board) to establish and administer an optional defined contribution retirement program within the existing Florida Retirement System (FRS), effective June 2002. Under the defined contribution retirement program, each participant has the opportunity to direct the investment of retirement dollars into selected investments. The defined contribution retirement program participants will enjoy retirement benefits based on the market return of the participant-directed investment rather than the fixed benefit guaranteed under the defined benefit retirement program.

Under the current law, the Board will contract with a third party administrator to provide administrative services to the participating employers and the program participants. The Board will also select investment products to be available in the optional program. To educate potential participants as to the risks and rewards of this program, the Board will also select one or more organizations to provide education to system members.

HB 347 amends certain provisions of the program:

- Directs that employers shall make contributions into the Public Employees Optional Retirement Program Trust Fund;
- Directs that the Board shall offer participants investment products and services exclusively through private bundled providers;
- Prohibits the Board from creating any of its own investment products or options;
- Amends the definition of "approved provider" to include and define the term "bundled provider;"
- Limits the third party administrator to perform those activities that are general to plan administration and directs that the approved providers shall perform those activities that are specific to a plan participant;
- Directs that there be five bundled providers including one who offers guaranteed annuities;
- Amends the criteria under which the Board shall select investment options or products; and
- Provides additional requirements of and for the approved providers regarding their relationship with plan participants.

The bill does not have a fiscal impact on state or local government expenditures. There will be a positive economic impact inuring to those selected private investment product providers. The impact of the proposed changes to the program on the retirement benefit of a plan participant is indeterminate.

HB 347 takes effect upon becoming law.

**There is a strike-everything amendment traveling with this bill. Please see "Amendments and Committee Substitute Changes" section of this bill analysis for a description.**

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- |                                   |   |                             |   |
|-----------------------------------|---|-----------------------------|---|
| 1. <u>Less Government</u>         | Yes <input type="checkbox"/>            | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 2. <u>Lower Taxes</u>             | Yes <input type="checkbox"/>            | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u>      | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/>            |
| 4. <u>Personal Responsibility</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/>            |
| 5. <u>Family Empowerment</u>      | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/>            |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

The State administers a retirement plan for the general employee population as well as several defined contribution plans for several population segments. The general plan is the Defined Benefit Retirement System, commonly known as the Florida Retirement System (FRS). The State also administers three optional defined contribution programs for certain segments of the employee population: the State University System Optional Retirement Program, the Senior Management Service Optional Annuity Program and the Community College Optional Retirement Program. These are briefly described below,

The State now provides, within the FRS, the newly created Public Employee Optional Retirement Program (PEORP) to the general employee population. It is described in detail below.

**Florida Retirement System**

Part I, Chapter 121, Florida Statutes, establishes the Florida Retirement System (FRS). The FRS is administered by the Division of Retirement within the Department of Management Services. Membership is compulsory for all employees working in regularly established positions for public employers participating in the FRS (state agencies, county governments, school boards, state universities, community colleges, or some cities and special districts).

The FRS is composed of five classes of membership -- Regular Class, Special Risk Class, Special Risk Administrative Support Class, Elected Officers' Class, and Senior Management Service Class. The Elected Officers' Class is further broken down into three sub-classes -- Judicial, Legislator/Attorney/Governor, and County Officers.

Generally, the Regular Class is comprised of all other personnel that do not qualify for another membership class. The Regular Class is eligible for normal retirement at age 62 with 10 years of service or at any age with 30 years of service. Generally, the Special Risk Class is comprised of law enforcement, firefighting, and correctional personnel. These personnel are eligible for normal retirement at age 55 with 10 years of service or at any age with 25 years of service. The Senior Management Service Class is comprised of selected personnel filling policy-making or managerial positions. These personnel are eligible for normal retirement at age 62 with 7 years of service. The Elected Officers' Class is comprised of elected officers.

The time to vest varies among the membership classes. The Regular Class, Special Risk Class, and Special Risk Administrative Support Class members must complete at least 6 years of creditable service in the FRS before their benefits vest. Members of the Elected Officers' Class must complete at least 8 years of service and members of the Senior Management Service Class must complete at least 7 years.

The annual accrual service credits used in calculating the retirement benefits also vary among the classes. The Regular Class and Special Risk Administrative Support Class earn 1.6% of average final compensation for each year of creditable service; the Senior Management Service Class earns 2.0% credits; and the Special Risk Class and Elected Officers' Class earn 3.0% credits.

Finally, the demographics, experience, and benefit design of each of these classes is different and result in different contribution rates being paid into the FRS Trust Fund by employers based on the class of membership of each member of the FRS. These rates are periodically revised to reflect changes in economic conditions and benefit design.

For the member-retiree, a key design feature in the defined benefit program is the guaranteed lifetime payments at a predetermined level for retirees. Once retired, the member may elect to receive benefits either:

- a. for the member's lifetime with no continuing benefit at death (option 1);
- b. a reduced benefit for life and, if the member dies within 10 years of retirement, a benefit to a beneficiary for the remainder of the 10 years (option 2);
- c. a reduced benefit for life of the member; upon the member's death a joint annuitant receives a lifetime benefit (unless the joint annuitant is a child -- then only until age 25) (option 3); or
- d. a reduced benefit for the life of the member or joint annuitant; upon the death of either, the survivor receives a lifetime benefit equal to 2/3's of the benefit received when both were living (unless the joint annuitant is a child -- then only until age 25) (option 4).

The FRS provides disability retirement benefits to its members as an incidental benefit as well as a health insurance subsidy.

### **Other Defined Contribution Retirement Programs**

Three segments of the State's employee population can participate in specific defined contribution programs:

- the State University System Optional Retirement Program (about 10,000 participants) for university instructional and research faculty, administrators, professionals, university presidents and the Chancellor;
- the Senior Management Service Optional Annuity Program (fewer than 100 participants) for those holding a position in the Senior Management Service class; and
- the Community College Optional Retirement Program (about 920 participants) for community college instructional personnel and certain management positions determined by a community college.

Contributions into the participants' accounts are equal to the normal cost portion of the employer's required retirement contribution for the year for the membership class of the employee plus an amount equal to the retiree health insurance subsidy.

Finally, as authorized in Chapter 2000-169, Laws of Florida, under the Senior Management Service Optional Annuity Program, benefits are payable only as a lifetime annuity to the participant or beneficiary, as a lump-sum payment upon the participant's death or as a cash-out of a de minimus account (\$5000 or less).

### **The Public Employee Optional Retirement Program (PEORP)**

Chapter 2000-169, Laws of Florida, creates an optional defined contribution retirement program, the Public Employee Optional Retirement Program (PEORP), within the Florida Retirement System (FRS). The plan is non-contributory, meaning the employer pays the full cost of the retirement benefit. Public employees will have the opportunity to choose to participate in either the defined benefit retirement program (the current plan) or the defined contribution retirement program.

The optional retirement program is administered by the Board. The Board is to contract with a third party administrator to provide administrative services to the participating employers and the program participants. The Board will also select investment products to be available in the optional program. The Board will also contract with an education provider to inform potential participants of the program.

Chapter 2000-169, Laws of Florida, also provides definitions necessary to operate the program and duties of the program trustees, program administrators and contractors, participating employers and employees, and various state agencies and oversight boards. The law provides authority to operate the program and criteria by which to evaluate products to be offered under the program. It also provides for statements concerning the administration of the program under section 401(a) of the IRS code, and fiduciary requirements under federal ERISA standards. The law also provides for treatment of participants under the social security program, eligibility requirements for the state retiree health insurance subsidy, and certain program administrative details.

### Program duties of the State Board of Administration and others

The law provides for duties of the Board, its program contractors, and employers. Among its duties, the Board is charged with:

- a. Adopting rules establishing the roles and responsibilities of the various parties involved in the program;
- b. Establishing criteria to evaluate, select, and contract with a third party administrator to provide administrative services;
- c. Establishing criteria to evaluate, select, and contract with organizations to provide educational services;
- d. Contracting with any consultant for professional services, including legal, accounting, consulting, and actuarial services, and investment advice;

- e. Developing the form and content of all contracts offered under the optional program; and
- f. Resolving conflicts between the third party administrator and any approved provider.

The law also provides for the selection, evaluation and monitoring of investment products and providers. Currently, the Board has the discretion to designate and contract for a number of investment products for use in the optional program. The Board is directed to contract with approved providers to offer multiple products and services when such an arrangement offers the participants value that is not offered through individual investment products. However, as a condition of offering any product through the optional program, the provider must agree to make the product available to the participants under the most beneficial terms afforded to any other customer (a "most favored nation" clause). The Board is required to monitor the performance of each product and provider and, when necessary, terminate the product or provider. Account balances in terminated products will be transferred to products that remain available under the optional program.

Finally, the Board is also require to develop an Investment Policy Statement for the optional program and products and providers must be in compliance with the policy statement.

The Department of Management Services is directed to adopt rules necessary to implement the optional program in coordination with the defined benefit retirement program and to contract with consultants for professional services, including legal, consulting, accounting, and actuarial services, and with the third-party administrator to provide some services to the defined benefit program.

The duties of the third party administrator (TPA) are to provide administrative services to the optional retirement program, including consolidated billing; individual and collective record keeping and accounting; asset purchase, control and safekeeping; and direct disbursement of funds.

The TPA will operate the mechanism to distribute contributions in the optional program. The employers will pay the appropriate contributions to the TPA. The TPA will distribute the applicable contributions to the Department of Management Services (disability and health insurance subsidy contributions), to the Board (administrative costs) and to the participant's accounts.

The duties of the education contractor are to provide educational services to employers, employees, participants, and beneficiaries.

There are two advisory groups to the Board concerning the PEORP created by the law. First is the Investment Advisory Council which may comment on the recommendations regarding selection and evaluation criteria to be used for the investment products and providers. Second is the Public Employee Optional Retirement Program Advisory Committee. This seven member body will make recommendations on the selection of the third party administrator, the education providers, and investment providers and investment products. The Committee's recommendations on the third party administrator were due by January 1, 2001; the recommendations on the education providers are due by April 1, 2001. Its recommendations on the investment products and providers also may be provided on a continuing basis.

### Program Provisions Relating to Employees

Chapter 2000-169, Laws of Florida, also provides for the requirements of employees to qualify for, vest in, and receive benefit disbursements under the PEORP.

First, the law provides for a definition of employee and specific eligibility requirements for participation in the optional retirement program. Participation in the optional program is in lieu of participation in the defined benefit program and if transferring from the defined benefit program, a participant will retain any

earned benefit under the defined benefit program. The law provides that the Board must establish transfer procedures by rule and provides for a methodology of valuing a participant's accumulated benefit obligation under the defined benefit plan. The transfer must occur no later than 30 days after the member's election to participate in the defined contribution program.

The law sets a phase-in schedule for current employees to elect participation in the optional program. Employees of state entities will be given the option to join the optional program between June 1, 2002, and August 31, 2002. Employees of education-related employers will have the option between September 1, 2002, and November 30, 2002. All other local government employees will be given the option to join between December 1, 2002, and February 28, 2003. New employees hired after an option window has opened for their employer will have 180 days to elect to participate. After the election window is closed, each employee will have one additional opportunity to choose to move from one program to the other program.

There are vesting requirements for the optional program. To vest in the employer contributions made under the optional program, the participant must complete 1 work year of service. Former service under the defined benefit retirement program is counted for the purposes of vesting in the optional program contributions. To vest in the balance transferred from the defined benefit retirement program, the participant must complete 6 years of creditable service. Again, service under the defined benefit retirement program and the optional program are used to compute these years. If a participant fails to vest in any portion of the optional retirement program accumulations prior to terminating, the participant has 5 years to return to employment. Failure to return to employment within the 5 years results in a forfeiture of the unvested accumulation, including any unvested amount transferred from the defined benefit program.

The law provides for the payout of retirement benefits from the program. Unlike the defined benefit retirement program, the defined contribution program offers retirement payments that are not fixed for a lifetime. The benefit payout methods must be in compliance with s. 401(a) of the Internal Revenue Code. To receive any benefit payments, the participant must be terminated from all employment with FRS employers. Benefits are payable to a participant as:

- a. A lump sum;
- b. A lump sum direct rollover to another plan; or
- c. Periodic distributions, as authorized by the SBA.

Benefits are payable to a beneficiary of a participant as:

- a. A lump sum;
- b. An eligible rollover to an individual retirement account or annuity, or
- c. A partial lump-sum payment and an eligible rollover.

#### C. EFFECT OF PROPOSED CHANGES:

House Bill 347 amends provisions of s. 121.4501, F.S., the Public Employee Optional Retirement Program, to provide for the types of providers and products to be offered plan participants and for provider responsibilities under the program and with regard to providers' relationships with participants.

#### D. SECTION-BY-SECTION ANALYSIS:

##### **Section One.**

- Amends s. 121.4501(1), F.S., to provide that employer contributions shall be deposited in the Public Employee Optional Retirement Program Trust Fund (to be created with

enactment of House Bill 503); directs that the Board shall offer participants investment products and services exclusively through private bundled providers; and prohibits the Board from creating any of its own investment products or options;

- Amends s. 121.4501(2)(a), F.S., to amend the definition of “approved provider” to include and define the term “bundled provider;”
- Amends s. 121.4501(8)(b)2., F.S., to limit the third party administrator to performing those activities that are general to plan administration and directs that the approved providers shall perform those activities that are specific to a plan participant;
- Amends s. 121.4501(9)(a), F.S., to provide that there be five bundled providers including one who offers guaranteed annuities;
- Amends s. 121.4501(9)(b)1., F.S., to provide within the mix of investment products that there “shall [be] include[d] a guaranteed account as well as investment products that offer the option of receiving lifetime income consistent with the long-term retirement security of a pension plan and similar to the lifetime income benefit provided by the Florida Retirement System;”
- Amends s. 121.4501(9)(b)2., F.S., to provide among the types of products offered, there “shall [be] include[d] products that give participants the option of committing their contributions for an extended time period in an effort to obtain higher returns than could be obtained from investment products offering full liquidity;”
- Amends s. 121.4501(9)(b)3., F.S., that the prohibition on sales charges shall not be applied to “fees or charges on lump-sum distributions that are based primarily on liquidity risk management;”
- Creates s. 121.4501(9)(b)4., to provide that fees such as mortality and expense risk charges shall be reasonable relative to the benefits provided;
- Creates s. 121.4501(9)(f)1.- 5., to provide additional responsibilities for providers:
  - providers are to comply with all federal, state, and NASD laws, rules, regulations and guidelines governing the marketing of products and to include as a contractual obligation the establishment and maintenance of a program to ensure that provider employees adhere to the requirements;
  - providers are to ensure that personnel interacting with participants provide independent and unbiased determinations of the suitability of a product to a participant;
  - with regards to complaints against providers, the Board is to establish a complaint process for referral of complaints to the appropriate regulatory body;
  - providers are to be responsible for providing accurate information to participants, are prohibited from representing that any one provider is the sole provider of investment products or services under the program, and to require the referral to the third party administrator of inquiries about other provider products; and
  - provider are prohibited from selling any customer lists or participants identification information generated from through their offering of products or services through the program.

## **Section Two.**

Provides that the Act shall take effect upon becoming law.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

There will be a positive economic impact inuring to those selected private investment product providers.

D. FISCAL COMMENTS:

The impact of the proposed changes to the program on the retirement benefit of a plan participant is indeterminate. It would seem that regardless of the number of providers, the results of a participant's investment efforts would appear more dependent on the choice of investment vehicle and its performance and fees than on the variety of investment products and services offered.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that counties or municipalities have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.



V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

None.

B. RULE-MAKING AUTHORITY:

None.

C. OTHER COMMENTS:

On page 2, lines 28 through page 3, line 2 of the bill (page 2, lines 26 – 30 of the amendment), appears a flush left paragraph that is actually part of the definition of employee (s. 121.4501(2)(d), F.S. As that definition it is not being amended by the bill, it would be appropriate to amend this language out of the bill as it is clearly a scrivener's error.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

On March 15, 2001, the Committee on State Administration heard HB 347 and adopted a strike-everything amendment that is traveling with the bill.

The amendment makes the following changes to the bill:

- Removes the limitations on the types of providers and products to be offered under the plan;
- Provides a participant a second election to return from the PEORP to the defined benefit program under the FRS;
- Provides that services provided by the third party administrator shall not duplicate those provided by the Division of Retirement within the Department of Management Services;
- Alters the division of labor of administrative services to provide that nothing in the section describing those administrative services shall prevent or prohibit a bundled provider from providing any administrative or customer service (previously the provider was mandated to provide such services);
- Provides that there be five bundled providers offering nine investment products; and
- Restates language concerning products that provide higher returns in exchange for the participant's commitment of contributions for an extended period of time;

VII. SIGNATURES:

COMMITTEE ON STATE ADMINISTRATION:

Prepared by:

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