

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 436

SPONSOR: Governmental Oversight and Productivity Committee and Senator Garcia

SUBJECT: Public Employee Optional Retirement Trust Fund

DATE: April 17, 2001 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	Favorable/CS
2.	_____	_____	AGG	_____
3.	_____	_____	AP	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill creates a trust fund for the transfer of employer contributions on behalf of participant members in the Public Employees Optional Retirement Program in the Florida Retirement System.

This bill creates s. 121.4502 and amends s. 121.4501 of the Florida Statutes.

II. Present Situation:

The Florida Retirement System (FRS) is a defined benefit (DB), non-participatory, multi-employer pension plan covering the employees, survivors, and dependents of some 800 Florida state agency and local government employers. It offers a monthly benefit payable in the form of an annuity over a retiree's lifetime that is calculated as a percentage of the average highest five years' of a member's average final pay. The FRS is composed of several sub-classes of membership with separate benefit accrual rates: Regular (1.60 percent-1.68 percent); Special Risk (3.00 percent); Special Risk, Administrative Support (1.6 percent); Senior Management (2.0 percent); Justices and Judges (3.33 percent); and Elected Officers (3.0 percent).¹ Normal, unreduced retirement occurs at the earlier completion of 30 years of service or age 62, or 25 years of service and age 55 for the two special risk classes. Members must satisfy minimum service periods in order to qualify, or vest for benefits. Effective July 2001, the three separate vesting periods of 7, 8, and 10 years will be collapsed into one uniform 6-year period.

¹Accrual rate is the pension value per year of creditable service. Accrual rate multiplied times total creditable service length in years multiplied times average final compensation (inclusive of up to 500 hours of annual leave) equals an Option 1 benefit for the life of the named retiree only. There are three other reduced payment options that incorporate survivors' benefits.

Incorporated within the DB plan is a disability retirement provision that provides in-line-of-duty and non-duty retirement payments.

The FRS is a predominantly local government plan with state officers and employees comprising only about 25 percent of the total membership. The other principal employer categories are district school boards, counties, and community colleges. Membership is compulsory for state agencies and constitutional entities. Municipalities and independent special districts may participate as optional members upon resolution of their governing authorities. Withdrawal of optional membership can be affected only by statute and was last done in 1995 for public hospitals.

Benefit administration is the responsibility of a state agency, the Division of Retirement in the Department of Management Services. Investment activities are conducted by a constitutional agency, the State Board of Administration, headed by the Governor, Comptroller, and Treasurer in their collegial capacity as Trustees of the Florida Retirement System. Article X, s.14, State Constitution, provides that all public pension plans in the State of Florida must fund promised benefits in advance in a sound actuarial manner.

The FRS was created in 1970 as the successor benefit plan to the separate Teachers' Retirement System, Highway Patrol retirement plan, and State and County Officers' and Employees Retirement System. The predecessor teachers' plan was approaching insolvency and its combination with the other solvent plans rescued it from collapse. In 1972 the FRS incorporated the last independent state retirement plan, the Judicial Retirement System. Today it covers about 600,000 active employees and nearly 200,000 retirees. Active members may choose to participate in a Deferred Retirement Option Program (DROP) during the last five years of their service.² Under its provisions participants have their monthly pension benefit paid into an interest bearing account. Upon termination of employment they receive the additional options of a full or partial lump sum payment of that amount plus its accrued 6.5 percent interest or they may transfer the account balance into a qualified retirement plan.

Retired members receive a 3 percent fixed cost-of-living allowance each July 1 on their monthly benefit. Members who have terminated employment with vested rights, that is, the right to receive a benefit, do not have these benefits indexed to inflation until commencement of pension payments. State of Florida employees have the option of maintaining their health insurance coverage at retirement at full cost less a monthly Health Insurance Subsidy payment equal to \$5 per month per year of service, not to exceed \$150.

Between 1984 and 1999 the Legislature created three other alternative pension arrangements to the FRS for covered employees. Administrators and faculty in the State University System and the Community College System and executives in the Senior Management Service may enroll in a defined contribution plan. About 12,000 employees among all three employer types have selected this choice. A defined contribution (DC) plan offers the participant the choice of pension portability from employer to employer, 1-year instead of 6-year vesting, and personal ownership of, as well as personal responsibility for the investment choices. These plans are

²Participation in DROP requires the member to qualify for normal retirement. Retirees seeking early benefits must incur a 5 percent per year penalty measured from age 55/age 62 and are barred from participation.

“front-loaded,” that is, they provide immediate ownership of pension dollars without any forfeiture should the participant terminate employment prior to vesting. Employer contributions are pre-tax and are roughly equivalent to the same DB contribution. Employees may make post-tax contributions to their DC accounts subject to federal earned income limitations. They stand in marked contrast to “back-loaded” DB plans which are structured to encourage career commitment and value the last five years as the most valuable. A DC plan assures only an employer payroll contribution, not a benefit result. The time-honored euphemisms of “thirty and out” and “high five” no longer apply: net asset value at the close of markets is all there is. The Florida DC plans, unlike many of their corporate 401(k)-type counterparts, are also structured as annuities and do not offer lump-sum features.³ Counties and school boards have the additional statutory authority to offer early retirement annuities to their departing members to compensate them for any penalties they may incur for non-normalized benefits.⁴

In 1999 the Florida Senate passed Senate Bill 356. It was designed to create a DC and DB pension choice for most members of the FRS.⁵ Participants would be able to enroll in the plan of their choice and receive an equivalent payroll contribution, then set at 9.21 percent of salary, by their employer. The choice would be unconstrained and would be accompanied by employee education and information on the elements and consequences of choice. The bill was patterned after the existing optional retirement plan choices for educators and managers and the state’s deferred compensation program. Employees would enroll with one or more of the several qualified investment and insurance providers that would offer whatever array of services, or the “bundle,” the participant believed valuable to purchase. The bill did not pass the House of Representatives but did precede the discussions undertaken during the 2000 Regular Legislative Session that resulted in passage of ch. 2000-169 (HB 2393/SB 1026), Laws of Florida.

Senate Committee Interim Report 2001-021, “Implementation of Pension Choice for Florida Public Employees”⁶ discussed in greater detail how public employee benefit programs are beginning to emulate the large-scale economic transformation from a job-based to a knowledge-based environment. The report traced the evolution of the Special Category appropriation and the increasingly greater role played by government contractors and their supplanting of direct service delivery by public employees. That shift from direct to indirect service delivery was accompanied implicitly by a shift from DB to DC pension management as contractors do not envision creating streams of unfunded employer liabilities in a competitive market where business infrequently exists for a lifetime.

Chapter 2000-169, L.O.F., created a Public Employees Optional Retirement Program and provided all employee participants of the FRS the opportunity to enroll initially in a DC plan or to transfer with a discounted account balance from the DB. Each category of public employer –

³The numerical labels assigned plans derive from their respective sections of the Internal Revenue Code, Title 26 U.S.C. A 401(a) is a government plan; a 401(k) is a corporate pension plan; a 403(b) is a plan for non-profit research and education institutions; and a 457 plan is not a pension plan but a salary deferral plan. Each has unique and overlapping qualifications and coordination of benefit features.

⁴Similar provisions were enacted in prior years on an individual agency basis for departing employees of the Department of Education and the Department of Labor and Employment Security. There is, however, no general statutory provision for state agencies.

⁵The bill extended coverage to all members of the Regular Class, then some 91 percent of total plan membership.

⁶Senate Committee on Governmental Oversight and Productivity, Tallahassee, FL: November 2000.

state, county, school board, and optional member – would be afforded a 90-day election window in which their employees could select the optional plan. Like SB 356 the choice was unconstrained – the failure to choose would maintain DB membership - and was to be accompanied by a broadly based information and education curriculum.⁷ Unlike that previous legislation, however, the plan would permit employees to transfer back to the DB plan once after their DC enrollment. It also would be organized on a wholesale, or “unbundled” basis in which the SBA would select the fund providers and slot them into predetermined asset classes. In this arrangement provider companies would compete on the basis of cost and performance of their individual investment offerings. They would not provide ancillary services to the participant such as estate planning, related investment products, or plan servicing as those elements became either non-existent or made the responsibility of an SBA retained third-party administrator. The disaggregation of services was a central feature of ch. 2000-169, L.O.F., as it contemplated overlaying the investment infrastructure of the SBA over the procured best-of-class funds to produce superior returns at minimal participant cost. The SBA believed itself to be in a commanding presence to produce this result, not only as a consequence of the stated objective of the law, but also by virtue of the procurement fitting into its own organizational deployment: it purchases on a wholesale basis as an institutional investor for the DB plan. Neither it nor the Division of Retirement engages in any ancillary activities outside the narrow scope of investment management and benefit administration thus keeping expenses low enough that the division reports itself as the national public pension plan leader in organizational efficiency as measured by cost per member.

The SBA has proceeded since the passage of ch. 2000-169, L.O.F., with the assembly of the implementing apparatus. In coordination with its own Investment Advisory Council and the separately created Public Employees Optional Retirement Plan Advisory Committee it has created four distinct work groups: an *Investment Services Implementation Group (no providers yet selected)* for the selection of investment products; a *Third Party Administrator Implementation Group* for the qualification and selection of a centralized financial services intermediary (CitiStreet); an *Education Services Provider Implementation Group* for initial and transfer education (Ernst and Young/Financial Engines/Watson Wyatt); and an *Asset Transition Work Group (pending)* for the brokerage transactions incidental to the transfer of account balances from DB to DC. In the course of its public hearings, the SBA has published an Investment Policy Statement (IPS) in which it outlined the plan design and procurement objectives. The IPS has been promulgated additionally as a rule under the state’s Administrative Procedures Act, ch. 120, F.S. The statement and the rule have been legally challenged in administrative proceedings by employees and provider companies. Generally, the challenges suggest that the board’s interpretation of the statute fails to allow for the permitted inclusion of guaranteed products, or annuities, and conducts such a narrow reading of the statute text as to exclude provider companies with fully aggregated offerings. The advisory bodies have recommended alternations to the IPS and these have received the concurrence of the plan trustees.

⁷Title 29C.F.R. 2550.404c of the Employee Retirement Income Security Act (ERISA), imposes fiduciary standards on plan sponsors to provide information, education, broad investment options, and meaningful control over participant accounts. ERISA standards are generally not applicable to government plans. Florida is perhaps unique in the nation in that both the DB and DC plans are required to be ERISA-compliant by state law.

To maintain federal tax-exempt status, the FRS is required to be in compliance with the Internal Revenue Code. A portion of the compliance requirements mandate the creation of a trust account for the segregation of participant contributions from other financial accounts. Because Florida law imposes strict requirements on the creation and periodic review of such trust funds⁸, this bill becomes necessary to execute the provisions of ch. 2000-169, L.O.F.

III. Effect of Proposed Changes:

Section 1. The bill creates s. 121.4502, F.S., and creates the Public Employee Optional Retirement Program Trust Fund to hold the assets of that optional retirement program as required by the Internal Revenue Code and s. 121.4501, F.S, for the exclusive benefit of participants and the payment of reasonable program expenses. The trust fund is made exempt from the service charges imposed by s. 215.20, F.S., on trust funds in the state treasury.

Section 2. The bill amends ss. 121.4501(13), F.S., to give the SBA rule-making authority consistent with ch. 2000-169, Laws of Florida, provided the rules do not make substantive changes to the law.

Section 3. The act takes effect July 1, 2001.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact:

None.

⁸Art. III, s.19(f), State Constitution.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The provision adopted in the Committee Substitute conferring limited rule-making authority on the SBA is consistent with the existing law creating the optional retirement program. At its best, the provision only restates the obvious: that a rule may not exceed the bounds of the authorizing statute. At its worst, the language chosen is marginally related to the narrow purpose of creating a trust fund.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
