

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: CS/SB 210

SPONSOR: Governmental Oversight and Productivity Committee

SUBJECT: Deferred Compensation Programs

DATE: December 8, 1999 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Wilson</u>	<u>Wilson</u>	<u>GO</u>	<u>Favorable/CS</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

I. Summary:

The bill authorizes the development, subject to appropriation and employee matching contributions, of a supplemental deferred compensation program. The program would constitute a non-pension savings account available to all participating employees to be administered by the State Treasurer for state employees and the respective units of local government which elect to create such a plan.

The bill also permits, but does not mandate, that local constitutional officers may enter into interlocal agreements to permit the combination of their separately constituted deferred compensation accounts.

This bill substantially amends section 112.125, Florida Statutes.

II. Present Situation:

Section 457 of Title 26 of the United States Code permits the establishment of a salary deferral program to shield income from payment of federal income taxes. While an employer sponsors the creation of such a plan, all of the contributions are made by the employee who, through the provider companies authorized to manage the deposited funds, bears all of the investment risk. In this sense a 457 plan is not a pension account for which the public employer is a fiduciary.

The Office of the State Treasurer administers the State of Florida Deferred Compensation Plan and periodically undertakes a competitive procurement of provider investment companies to act as fund managers for participating employees. Currently there are several provider entities representing insurance companies, mutual funds, and savings institutions. Each provider company permits the participants to allocate funds among a variety of fixed and variable fund accounts according to the individual's perceived degree of comfort and personal financial objectives. About \$1.3 billion is credited to these accounts although only about 30% of all employees participate. At the cessation of employment participating employees may withdraw contributions and their

earnings in a full or partial lump sum or annuitize the payments over a period of years, subject to the contract provisions of their provider company. Employees may withdraw funds for specified hardship reasons; unlike corporate-type 401(k) pension arrangements, they are under no obligation to repay these withdrawn amounts with interest.

Deferred compensation contribution limits are indexed under federal law to the inflation rate in \$500 increments. The present limits are 25 percent of salary not to exceed \$8000 per year. In the last three years of employment a participant may double contributions, although that indexed threshold is presently \$15,000.

Section 401(a) of the Internal Revenue Code authorizes general government pension plans including supplemental accounts for salary deferral purposes.

III. Effect of Proposed Changes:

The bill authorizes a public employer, through its appropriate legislative body, to create a Section 401(a) supplemental deferred salary plan to the base Section 457 plan. The bill authorizes the appropriate legislative body to provide for matching payments as a condition of employee participation. These employer matching payments may be authorized annually in the legislative body's appropriation documents and may take the form of a fixed or percentage amount to be matched by the employee.

The bill further authorizes constitutional officers in local government entities to permissively combine their deferred compensation program operations by entering into an interlocal agreement. The bill, however, makes any such combination voluntary with each constitutional officer.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

The implementation of such a program is optional with each unit of local government. A 1999 survey undertaken by the Legislative Committee on Intergovernmental Relations on behalf of this Senate committee indicated that virtually all responding local governments had Section 457 plans in effect. Implementation will be determined either unilaterally by the local government or bilaterally in connection with designated collective bargaining agents representing its employees.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

Salary deferral plans are already covered by a trust requirement for the protection of employee funds.

V. Economic Impact and Fiscal Note:**A. Tax/Fee Issues:**

Because salary deferral programs shield current income from federal taxes they constitute a tax expenditure to the federal treasury. Depending upon the participant's tax bracket this means that anywhere from 15 percent to 28 percent of otherwise net taxable income is not paid to the United States' Treasury until a distribution is taken.

B. Private Sector Impact:

Expansion of salary deferral programs will have a salutary effect upon the provider companies who will be able to command an increased share of business. Each company imposes its own set of account fees under supervision of the Bureau of Deferred Compensation in the Division of Treasury.

Active employer encouragement of workplace savings lessens the emphasis placed upon government-provided retirement income and gives the participant wage-earner personal ownership of the account contributions and its earnings.

C. Government Sector Impact:

The Division of Treasury reports that the current regulatory and investment management company infrastructure can handle expanded participation within currently appropriated resources. In theory, at least, the larger the salary deferral program becomes, the greater the ability of the state to negotiate lower fees due to its increased purchasing power. Fees are negotiated at the wholesale level by the public employer while individual investors making private purchasing decisions in the open market would pay them at the retail level.

As drafted, the bill would make an employer's match contingent upon employee participation. This means that the employee foregoes the match if participation is rejected. The minimum monthly contribution for state salary deferral programs is \$20.

State employees undertaking part-time, seasonal, or temporary duties and paid from the *Other Personal Services* budget category are also eligible for participation in Section 457 plans even though they are barred by Florida law from participating in the Florida Retirement System.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The National Association of Government Deferred Compensation Administrators reports that there are five state and local government plans in operation today (the States of Minnesota, Missouri, Maryland, Oklahoma, Tennessee, and the County of Los Angeles, California); three

plans authorized by legislation (the States of Colorado, Indiana, and Virginia); and six plans under active consideration (the States of Delaware, Iowa, Mississippi, Texas, Washington, Wisconsin, and the City of Houston, Texas).

The language used in this bill is based upon the statute in the State of Indiana.

The bill is an outgrowth of 1999 Committee Interim Project 2000-51, *Employer Incentives for Employee Savings*.

Many large private sector companies utilize such savings, or thrift plans, alone or in combination with dividend reinvestment and stock ownership plans. Such features are especially popular in companies which have high capital requirements (natural resource) or are interest rate sensitive (public utilities).

The deferred compensation provider companies in 1998 for the State of Florida are: Aetna Life Insurance and Annuity Company; Great American Reserve Company; Great West Life and Annuity Insurance Company; Nationwide Insurance Company; Security First Life Insurance Company; T. Rowe Price Associates; Variable Annuity Life Insurance Company; and Washington Mutual Bank.

The Florida Retirement System, the multi-employer state and local government pension plan, bears all of the investment risk for its 600,000 active and 170,000 retired members. Its benefit design guarantees a retirement income based upon an employee's average final pay. Membership in this plan is automatic for all employees, except for those management and university faculty employees who elect an alternative pension arrangement in which they bear all investment reward and risk. Salary deferrals under either a Section 457 or 401(a) plan do not adversely affect benefits payable to state retirement system pensioners: they shield a portion of income from *federal* taxation only.

Since 1994 the Legislature has implemented a salary policy which rewards employees at lower salaried levels with a higher percentage cost-of-living adjustment. This policy has led to a dramatic reduction in the number of employees paid less than \$18,000 in annual salary. A consequence of this has been a reduction in the number of state employees eligible to qualify for federally subsidized assistance programs. This reduction becomes even greater when spousal household income is considered.

VIII. Amendments:

None.