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HOUSE OF REPRESENTATIVES
COMMITTEE ON
GENERAL APPROPRIATIONS
ANALYSIS

BILL #: HB 2393 (PCB GA 00-16)

RELATING TO: Retirement

SPONSOR(S): Committee on General Appropriations and Representative Pruitt

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:
(1) GENERAL APPROPRIATIONS YEAS 19 NAYS 1
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I. SUMMARY:

This legislation requires the Trustees of the State Board of Administration to establish and administer an optional defined contribution retirement program with the existing Florida Retirement System (FRS), effective FY 2002-03. The legislation also reduces the vesting requirement from 10 years to 8 years for the Regular Class, Special Risk Class and the Special Risk Administrative Support Class of the defined benefit retirement program, effective July 1, 2001.

For fiscal year 2000-01, approximately $93 million will be used from the actuarial surplus of the Florida Retirement System Trust Fund to offset the costs of this legislation and the 1999 actuarial experience study. The fiscal impact on the state is expected to be $18.2 million in FY 2000-01 and $31.8 million in FY 2001-02. The fiscal impact on local governments participating in the Florida Retirement System is expected to be $87.6 million in FY 2001-02 and $99.2 million in FY 2002-03.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1.	Less Government	Yes [x]	No [x]	N/A []
2.	Lower Taxes	Yes []	No [x]	N/A []
3.	Individual Freedom	Yes [x]	No []	N/A []
4.	Personal Responsibility	Yes [x]	No []	N/A []
5.	Family Empowerment	Yes []	No []	N/A [x]

Less Government -- This legislation privatizes some portion of the public retirement system by authorizing the State Board of Administration to contract with private sector investment managers invest the public pension funds under the Public Employee Optional Retirement Program. In addition, a new third party administrator will administer the optional program, potentially reducing the responsibility of the Division of Retirement. On the other hand, this legislation requires a significant state-sponsored retirement education effort directed at members of the Florida Retirement System. The State Board of Administration also has increased responsibility in overseeing the successful implementation of the Public Employee Optional Retirement Program, including the authorization of up to 20 FTEs.

Lower Taxes -- This legislation reduces the vesting requirements for Regular Class, Special Risk Class and Special Risk Administrative Support Class. To implement these benefit enhancements, retirement contributions by employers must be increased. Upon implementation of the Public Employee Optional Retirement Program, the costs for participants in that program will exceed the costs required today under the defined benefit program by the current year increase in the defined benefit program. However, the costs of the defined contribution program will be stable, not fluctuating based on market earnings of the Florida Retirement System Trust Fund. To fund those personnel costs, employers may need either to increase revenues or to reduce other expenditures.

B. PRESENT SITUATION:

Chapter 121, Florida Statutes, establishes a defined benefit retirement system for public employees in Florida called 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 position 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.

The demographics, experience, and benefit design of each of these classes is different. This results in different contribution rates being paid into the FRS Trust Fund based on the class of membership of each member of the FRS.

For purposes of this legislation, one relevant distinction between classes is the time needed for a member to vest in the defined benefit entitlement. The Regular Class, Special Risk Class, and Special Risk Administrative Support Class members must complete 10 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.

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 his 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. To claim disability retirement, the member must be totally and permanently disabled. This means that the member is prevented, by reason of a medically determinable physical or mental impairment, from rendering useful and efficient service as an officer or employee. For regular disability (not in-line-of-duty related), the member must complete 10 years of creditable service to be entitled to a monthly disability. For in-line-of-duty disability, the member is entitled to the benefit regardless of service. The minimum annual in-line-of-duty disability benefit for all classes of FRS membership is 42% of average final compensation for an option 1 benefit. The minimum annual regular disability benefit is 25% of average final compensation for an option 1 benefit. The option 1 benefit is the maximum retirement benefit payable to the member during his or her lifetime.

C. EFFECT OF PROPOSED CHANGES:

Defined Contribution Program

This legislation creates an optional defined contribution retirement program within the Florida Retirement System pursuant to section 401(a) of the Internal Revenue Code. 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 program (the current plan) or the defined contribution program.

The optional retirement program will be administered by the Trustees of the State Board of Administration(SBA). 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. Because this type of program allows the participant to direct investments within the products offered, the risk of loss and the benefit of gains rests solely upon the participant.

Unlike the defined benefit program, the defined contribution program offers retirement payments that are not fixed for a lifetime. Rather, a participant may elect to receive the benefits in a lump-sum, by rolling over the distribution to another qualified investment, or in periodic distributions.

The Board will also select an organization to provide education to system members. Education is an important element of the program since employees will be allowed a one-time window to elect to participate in either the defined benefit or defined contribution programs.

Please see section by section below for more details of the program.

Defined Benefit Program

This legislation reduces from 10 years to 8 years the time required to vest in the defined benefit program for the Regular Class, the Special Risk Class, and the Special Risk Administrative Support Class.

D. SECTION-BY-SECTION ANALYSIS:

Section 1 amends s. 112.65, F.S., to clarify that benefits paid under the Public Employee Optional Retirement Program are supplemental benefits. Thus, the benefits attributable to the optional retirement program may exceed 100 percent of the employee's average final compensation.

Section 2 amends s. 121.021, F.S., to redefine the Florida Retirement System to include both a defined benefit retirement program and a defined contribution retirement program.

Section 3
Subsection (1) requires the Trustees of the State Board of Administration to create the Public Employee Optional Retirement Program. This program is an optional defined contribution retirement program generally open to employees of governmental employers participating in the Florida Retirement System.

Subsection (2) provides definitions necessary for the Public Employee Optional Retirement Program.

Subsection (3) provides the 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.

A participant will retain any earned benefit under the defined benefit program. However, the participant has the option to transfer the present value of the accumulated benefit obligation under defined benefit program to the participant's account in the defined contribution program.

The present value of the accumulated benefit obligation is determined by using the discount rate and other actuarial assumptions used at the most recent valuation of the FRS Trust Fund, and a benefit commencement age of 62 or a hypothetical age after 30 years of service, whichever is less. For Special Risk members, the benefit commencement age is 55 or a hypothetical age after 25 years of service, whichever is less. By using the lesser age rather than the greater age used by the retirement system, this legislation increases the amount that will be transferred.

If the participant elects to transfer the defined benefit balance to the optional program, at least 10 percent of the balance transfer must be invested in a stable value product.

Subsection (4) sets a phased 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.

Subsection (5) sets forth the mechanism to distribute contributions in the optional program. The employers will pay the appropriate contributions to the third party administrator. The TPA will distribute the applicable contributions to the department (disability and health insurance subsidy contributions), to the board (administrative costs) and to the participant's accounts.

Subsection (6) sets forth the 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 8 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.

Subsection (7) provides for the methods for benefit payments under this program. 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 Board.

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.

Subsection (8) provides the details of the administration of the program. The Trustees of the State Board of Administration, the Department of Management Services and the various employers will administer the program.

Duties of the Trustees of the SBA:

a. Adopt rules establishing the roles and responsibilities of the various parties involved in the program;
b. Establish criteria to evaluate, select and contract with a third party administrator to provide administrative services;

c. Establish criteria to evaluate, select and contract with an organization to provide educational services;
d. Contract with any consultant for professional services, including legal, accounting, consulting, and actuarial services, and investment advice;
e. Develop the form and content of all contracts offered under the optional program.

Duties of the Department of Management Services:

a. Adopt rules necessary to implement the optional program in coordination with the defined benefit retirement program;
b. Contract with consultants for professional services, including legal, consulting, accounting, and actuarial services, and the third-party administrator to provide some services to the defined benefit program.

Duties of the Third Party Administrator:

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.

Duties of the Education Contractor

Provide educational services to employers, employees, participants, and beneficiaries.

Subsection (9) provides for the selection, evaluation and monitoring of investment products and providers. The Trustees of the SBA have the discretion to designate and contract for a number of investment products for use in the optional program. The Trustees of the SBA also shall 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. 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 Trustees of the SBA are 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.

Subsection (10) provides details on the education component. The education component must be available to employees at least 90 days before the employees must make the election between the defined benefit program and the optional program. The education component will consist of initial and on-going transfer education for eligible employees, an on-going education and communication component for all employees, and a communication component for employers. All descriptive materials used in the education component must be approved by the SBA prior to dissemination.

Subsection (11) enumerates the requirements for the participant statements. The statements must be provided quarterly and must account for all contributions into the participant's accounts, the earnings of the account, any fees or other charges that apply, and the product's performance relative to appropriate benchmarks. The third party administrator must provide quarterly and annual statements to the SBA regarding the optional program.

Subsection (12) charges two advisory committees with oversight responsibilities. The Investment Advisory Council may comment on the recommendations regarding selection criteria to be used for the third party administrator. The Public Employee Optional Retirement Program will make recommendations on the selection of the third party administrator, investment providers and investment products; and on the selection, design and implementation of the education component.

Subsection (13) provides that the optional program will be administered so as to comply with the federal requirements under s. 401(a) of the Internal Revenue Code.

Subsection (14) requires the State Board of Administration to develop an Investment Policy Statement for the optional program. The products and providers must be in compliance with the policy statement.

Subsection (15) states that the fiduciary standards will be guided by federal ERISA standards.

Subsection (16) provides legislative intent regarding the disability benefits available to participants of the optional program. The Department of Management Services is directed to study the potential options of providing disability coverage and the fiscal impacts on employers and employees.

Subsection (17) provides that participants are covered by social security and are eligible to receive the retiree health insurance subsidy, subject to s. 112.363.

Section 3 also creates s. 121.571, F.S., to set the contribution rates for each class and each benefit under the optional program. The contribution rates are broken down into three categories -- participant accounts, disability and administrative/education -- and differ based on class membership. The contribution rates may be modified by general law.

Section 4 amends s. 121.021, F.S., to redefine “normal retirement date” by reducing the number of years of creditable service needed to retire at age 62 for Regular Class members from 10 years to 8 years and reducing the number of years of creditable service needed to retire at age 55 for Special Risk Class members. This section is effective July 1, 2001.

Section 5 amends s. 121.051, F.S., to correct a reference to the Florida Retirement System Trust Fund. This section is effective July 1, 2001.

Section 6 amends s. 121.0515, F.S., to allow special risk administrative support class to retain the special risk class normal retirement date (55 years old or 25 years of service) if the employee completes at least 8 years of service in the special risk class prior to retirement. This section is effective July 1, 2001.

Section 7 amends s. 121.052, F.S., to delete language made redundant by the reduction of the Regular Class vesting requirement from 10 years to 8 years. This section is effective July 1, 2001.

Section 8 amends s. 121.053, F.S., to correct a reference to the Florida Retirement System Trust Fund. This section is effective July 1, 2001.

Section 9 amends s. 121.081, F.S., to reduce the number of years of creditable service (from 10 to 8 years) that must be completed before a member can purchase past service. This section is effective July 1, 2001.

Section 10 amends s. 121.1115, F.S., to reduce the number of years of creditable service (from 10 to 8 years) that must be completed before a member can purchase out-of-state or federal service. This section is effective July 1, 2001.

Section 11 amends s. 121.1122, F.S., to reduce the number of years of creditable service (from 10 to 8 years) that must be completed before a member can purchase in-state service. This section is effective July 1, 2001.

Section 12 amends s. 121.121, F.S., to reduce the number of years of creditable service (from 10 to 8 years) that must be completed before a member can purchase service for up to 2 years for an authorized leave of absence. This section is effective July 1, 2001.

Section 13 amends s. 115.32, F.S., to correct a reference to the Florida Retirement System Trust Fund.

Section 14 amends s. 112.19, F.S., to clarify a reference to part I of chapter 121.

Section 15 amends s. 112.191, F.S., to clarify a reference to part I of chapter 121.

Section 16 amends s. 112.313, F.S., to clarify a reference to part I of chapter 121.

Section 17 amends s. 112.665, F.S., to clarify a reference to part I of chapter 121.

Section 18 amends s. 154.10, F.S., to clarify a reference to part I of chapter 121.

Section 19 amends s. 154.12, F.S., to clarify a reference to part I of chapter 121.

Section 20 amends s. 175.361, F.S., to clarify a reference to part I of chapter 121.

Section 21 amends s. 185.37, F.S., to clarify a reference to part I of chapter 121.

Section 22 amends s. 189.412, F.S., to clarify a reference to part I of chapter 121.

Section 23 amends s. 216.262, F.S., to clarify a reference to part I of chapter 121.

Section 24 amends s. 231.36, F.S., to clarify a reference to part I of chapter 121.

Section 25 amends s. 238.072, F.S., to clarify a reference to part I of chapter 121.

Section 26 amends s. 238.171, F.S., to clarify a reference to part I of chapter 121.

Section 27 amends s. 238.175, F.S., to clarify a reference to part I of chapter 121.

Section 28 amends s. 240.3195, F.S., to clarify a reference to part I of chapter 121.

Section 29 amends s. 650.05, F.S., to clarify a reference to part I of chapter 121.

Section 30 amends s. 112.363, F.S., to clarify what qualifications must be met for a retiree to be eligible to receive the retiree health insurance subsidy.

Section 31 amends s. 121.055, F.S., to allow small local governments to designate up to ten non-elected employees as senior managers. In addition, this provision allows Senior

Management Service Optional Annuity Program distributions to be rolled over into an individual retirement account.

Section 32 increases the retirement contribution rates to fund the increased costs resulting from the reduction of vesting requirements from 10 years to 8 years for the Regular Class, the Special Risk Class and the Special Risk Administrative Support Class.

Section 33 increases the retirement contribution rates to fund the increased normal costs resulting from the 1999 actuarial experience study, effective FY 2001-02 and thereafter. For FY 2000-01, a portion of the actuarial surplus of the FRS Trust Fund will be recognized to fund the cost.

Section 34 increases the retirement contribution rates to fund the increased normal costs resulting from the implementation of the Public Employee Optional Retirement Program.

Section 35 reduces the retirement contribution rates for each membership class by 0.1% for FY's 2000-01 and 2001-02. An additional assessment will be paid by each FRS employer equal to 0.1% of the gross compensation paid by the employer. These funds will be transferred to the State Board of Administration to fund the implementation of the Public Employee Optional Retirement Program. In addition, 20 FTEs are authorized for the State Board to implement the program.

Section 36 provides that the legislature finds that this act fulfills an important state interest.

Section 37 provides effective dates and a contingent implementation date for the program.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

For fiscal years 2000-01 and 2001-02, the State Board will receive approximately $20 million annually to be used to implement the Public Employee Optional Retirement Program. This assessment will be offset by a similar reduction to the retirement contribution rates applied for fiscal years 2000-01 and 2001-02.

2. Expenditures:

Florida Retirement System Trust Fund and associated contributions
The legislation provides increases the retirement contribution rates to fund the normal cost increases attributable to the 1999 actuarial experience study, the reduction in the vesting requirements for selected classes of membership and the implementation of the Public Employee Optional Retirement Program. The following fiscal impact on state agencies will be associated with the contribution rate increases.

Amount Year 1 FY 00-01	**Amount Year 2** FY 01-02	**Amount Year 3** FY 02-03
0	$18.2 million	$31.8 million

In addition, a portion of the actuarial surplus of the Florida Retirement System Trust Fund will be recognized to offset costs associated with the 2000-01 cost related to the actuarial experience study (anticipated to be approximately $73 million; of which, about $18 million is a savings to the state) and the reduction of 0.1% in contribution rates for all employers for fiscal years 2000-01 and 2001-02 (anticipated to be approximately $20 million for each year).

Start-up costs for implementation of the Optional Retirement Program
It is anticipated that the startup costs for FY 2000-2001 and FY 2001-2002 will be approximately $20 million per year. These costs include legal counsel, retirement consultants, programming costs, education component, and other expenses associated with the selection of the third party administrator, the educator, and the investment products and providers. These costs will be funded through an assessment against the gross compensation paid by those public employers participating in the Florida Retirement System.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

The following Fiscal Impact on Local Governments will be associated with the contribution rate increases described in Section III.A.2.

Amount Year 1 FY 00-01	**Amount Year 2** FY 01-02	**Amount Year 3** FY 02-03
$ 0	$87.6 million	$99.2 million

With the use of surplus to offset the FY 2000-01 costs attributable to the actuarial experience study, local governments will avoid a $55 million cost in the aggregate for the year.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Private sector entities that provide investment management may be selected to provide investment products and services to participants of the Public Employee Optional Retirement Program. Private sector entities that provide education on retirement planning may be selected to educate over 600,000 members of the Florida Retirement System.

D. FISCAL COMMENTS:

The retirement contribution rates for the defined benefit retirement program by class/subclass membership for each fiscal year are noted below:

	FY 1999-00	**FY 2000-01**	**FY 2001-02**	**FY 2002-03**
Regular Class	9.21%	9.11%	9.59%	9.90%

Special Risk Class	20.22%	20.12%	21.58%	21.69%
SR Admin. Supp. Class	11.53%	11.43%	12.26%	12.33%
Elected Officers Class:				
Judicial	20.48%	20.38%	20.53%	20.60%
Leg-Atty-Cabinet	14.31%	14.21%	14.25%	14.22%
County	17.05%	16.95%	17.11%	17.21%
Senior Mgmt. Serv. Class	11.19%	11.09%	11.48%	11.58%

The estimates of the increases to the normal cost of the defined benefit program as a result of the implementation of the optional retirement program are subject to change based on the demographics of the employee population that remains in the defined benefit program after the optional program is implemented.

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

A. APPLICABILITY OF THE MANDATES PROVISION:

This legislation will require counties and cities to spend money. However, the provisions requiring the expenditure of funds by cities and counties apply to similarly situated persons (all FRS employers) and the legislation contains a legislative finding that the provisions fulfill an important state interest. Thus, this legislation meets an exception set forth in the Constitution and is binding upon cities and counties.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This legislation does not reduce the revenue raising authority of cities and counties.

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

This legislation does not reduce the percentage of a state tax shared with cities and counties.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

This legislation grants the State Board of Administration and the Division of Retirement additional rulemaking authority to implement the Public Employee Optional Retirement Program.

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON GENERAL APPROPRIATIONS:

Prepared by:	Staff Director:
Joseph L. McVaney	David K. Coburn