

# 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.)

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Prepared By: General Government Appropriations Committee

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BILL: CS/SB 1024

INTRODUCER: Governmental Oversight and Productivity Committee and Senator Constantine

SUBJECT: Deferred Compensation Programs

DATE: April 18, 2006

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

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>McKay</u>	<u>Wilson</u>	<u>GO</u>	<u>Fav/CS</u>
2.	<u>Kynoch</u>	<u>Hayes</u>	<u>GA</u>	<u>Favorable</u>
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

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## I. Summary:

This bill permits employees of participating local governments to join deferred compensation plans sponsored by the State of Florida through the Department of Financial Services, and clarifies the duties of the State Board of Administration with respect to plans administered by the Chief Financial Officer.

This bill amends sections 20.121 and 112.215 of the Florida Statutes.

## II. Present Situation:

Workplace benefits provided to employees of State of Florida agencies are generally free from federal taxation under Title 26, United States Code, and the Internal Revenue Code.<sup>1</sup> The numerical subdivisions of Title 26 are used as popular citations for the specific benefit provisions:

- Section 401(a) - Government-sponsored pension plans.
- Section 401(k) - Corporate pension plans.
- Section 403(b) - Tax-sheltered annuities for educational, health care, and research-based non-profit entities.
- Section 457 - Deferred compensation programs.

The State of Florida deferred compensation plan, while not a pension plan, does permit an individual employee to defer from federal taxation a portion of gross income up to an annually

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<sup>1</sup> A premium charged for a benefit is also federally tax-sheltered under the authority granted by s. 110.161, F.S.

indexed amount for placement in a fund or funds of a prequalified investment provider.<sup>2</sup> Account earnings are similarly sheltered from federal taxation until a distribution occurs.

The Chief Financial Officer of the State of Florida directs the state's deferred compensation program through the Department of Financial Services (DFS), which acts as the sponsoring agency. DFS competitively selects several investment providers along with a record keeper. The advice of the State Board of Administration, the investment entity for the State of Florida and the Florida Retirement System (FRS), is solicited before the approval of investment vehicles or products. The department engages in a quarterly qualitative and quantitative reviews of provider company funds and may terminate them if their performance falls below a designated level.<sup>3</sup> Five of the six participating firms are insurance companies; the sixth is a mutual fund.<sup>4</sup> Because these are salary deferral programs, the participating employee bears all of the investment risk and is responsible for the payment of associated fees and costs charged by the provider. The fees and associated participant costs, or total investment management expenses, generally fall within a range between institutional, the lowest, and retail, the highest. The state plan operates under a long-term contract that was last amended in 2003.

Participant financial records are confidential and exempt from the public records access provisions of s. 119.07(1), F.S.

Each company provides an array of investment products permitting selection from fixed rate, guaranty of principal, Federal Deposit Insurance Corporation deposits, no-load mutual funds (purchased at net asset value), and securities. Products offered for sale require the provider company representative to have state insurance sales licensure or federal registration. Participants may select from as many funds or companies as they wish, provided the total deferral does not exceed the annually indexed deferral amount set in federal law. Some companies also offer products that permit employees to make social or value choices about investing that reflect their personal sensibilities. One company permits a more interactive trading experience with a brokerage window that allows selection and active trading from a larger group of listed stocks and mutual funds not offered by any of the other provider companies.

Section 112.215, F.S., authorizes all governments in Florida to create such programs but restricts enrollment eligibility to employees of State of Florida agencies.<sup>5</sup>

Since January 1, 2003, the State of Florida plan also permits provider companies to offer "Deemed Individual Retirement Accounts," also known as "sidecar IRAs," that are supplemental to the main plan offerings.<sup>6</sup> These plans permit additional contributions to the participant's Roth or traditional retirement account that does not count against Section 401(a) contribution limits.

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<sup>2</sup> Only withholding taxes on income may be deferred until withdrawal. Employee-paid Social Security and Medicare matching contributions still apply.

<sup>3</sup> More fully described in the department publication "Investment Policy and Product Selection and Retention Policy."

<sup>4</sup> The participating companies are AIG Valic; ING; Symetra ShareBuilder (formerly Safeco Life Insurance Company); Great West Retirement Services; Nationwide Retirement Solutions; and T. Rowe Price.

<sup>5</sup> Persons paid from Other Personal Services budget categories and considered part-time, seasonal, or temporary may still participate in this program even though they are denied eligibility for other State of Florida retirement programs pursuant to s. 216.011(1)(dd)2, F.S.

<sup>6</sup> Authorized by federal legislation, the Economic Growth and Tax Reconciliation Act of 2001.

Though permitted, the deferred compensation program has not implemented these plans due to pending clarification of federal tax issues.

### **III. Effect of Proposed Changes:**

This bill amends s. 112.215, F.S., to permit employees of governmental entities, not just state agencies, to participate in the state plan or plans of deferred compensation. The state plan or plans of deferred compensation could include all local and county government employees as well as employees of state agencies, constitutional offices, and the state university system. The bill provides that any county, municipality, or other political subdivision may adopt the state plan or plans of deferred compensation, adopt and use its own plan, or do both.

This bill clarifies that the State Board of Administration (SBA) will approve the initial establishment of any deferred compensation plan for state employees administered by the Chief Financial Officer (CFO), but that counties and municipalities will approve their own plans. The bill provides that the SBA will advise the CFO on the plan, but the CFO has sole responsibility for all decisions. The SBA may provide further assistance to the CFO pursuant to an agreement that sets out fees and services.

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

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

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds, or reduce the percentage of a state tax shared with counties or municipalities, or reduce the authority of counties or municipalities to raise revenue.

#### **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:**

Deferred compensation programs are participant-directed and the subscriber bears the full cost of the investment management expenses, which vary among the provider companies and the selected funds.

As of March 2005, there were 72,500 accounts in the state deferred compensation program with total assets of \$1.87 billion. Every one basis point (.01% or .0001) change in fees and expenses produces participant cost or savings of \$187,000. This would equate to \$2.58 on an average account balance of \$25,800 on an annual basis.

**C. Government Sector Impact:**

State universities have been reconstituted as non-state agencies but their eligibility for the state deferred compensation program was maintained under separate legislation.

Many local governments have their own Section 457 plans with varying types of fees and costs. As noted above, the State of Florida deferred compensation program has a fee structure that is priced below retail but is more expensive than the institutional level. For comparison purposes, funds approved for inclusion in the Florida Retirement System Investment Plan, a Section 401(a) defined contribution plan, must be priced at the wholesale, or institutional level, by law.<sup>7</sup>

Two of the largest national local government-affiliated deferred compensation providers are the National Association of Counties and its financial partner Nationwide Retirement Solutions, and the International City Managers Association Retirement Corporation.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

If an eligible employee of a unit of local government were to participate in both a local deferred compensation program and the state's deferred compensation program, the employee would need to closely monitor compliance with the contribution limits of Section 457, as neither plan would have information relating to contributions made to the other plan. Failure to comply with the contribution limits could cause federal taxation issues for an employee.

Plan sponsors have fiduciary duties under federal law, and proper execution of these duties imposes oversight and reporting requirements on them. Title 26 U.S.C. 457(g)(1) requires deferred compensation funds to be held in trust for the exclusive benefit of participants and beneficiaries. Plan sponsors also have other significant record-keeping and monitoring duties to these named parties that cannot be compromised. While government plans are exempt from the regulatory provisions of the Employee Retirement and Income Security Act of 1974 (ERISA), the Florida Retirement System and other Florida government pension plans adopt its provisions in ch. 121, F.S. or the respective implementing special acts or ordinances. The most noteworthy features of ERISA are its three principal fiduciary duties for plan sponsors: loyalty, such that actions are solely in the best interests of participants and beneficiaries; acting with care, skill, and prudence; and discharging duties with an exclusive, uncompromised purpose.

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<sup>7</sup> Section 121.4501(9)(d), F.S., provides: "As a condition of offering any investment option or product in the optional retirement program, the approved provider must agree to make the investment product or service available under the most beneficial terms offered to any other customer, subject to approval by the Trustees of the State Board of Administration."

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

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## **VIII. Summary of Amendments:**

None.

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