



# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. HOUSE PRINCIPLES ANALYSIS:

This bill does not appear to implicate any of the House Principles.

### B. EFFECT OF PROPOSED CHANGES:

#### Florida Retirement System

Chapter 121, F.S., is the Florida Retirement System Act and it governs the Florida Retirement System (FRS). The FRS is administered by the secretary of the Department of Management Services through the Division of Retirement.<sup>1</sup>

The FRS is the primary retirement plan for employees of state and county government agencies, district school boards, community colleges, and universities. The FRS also serves as the retirement plan for participating employees of the 158 cities and 192 independent special districts that have elected to join the system.<sup>2</sup>

The FRS offers a defined benefit plan that provides retirement, disability, and death benefits for over: 600,000 active members, 252,000 retirees and surviving beneficiaries, and 31,000 Deferred Retirement Option Program participants.<sup>3</sup> Members of the FRS belong to one of five membership classes:

|   |                 |                                  |
|---|-----------------|----------------------------------|
| 1. Regular Class <sup>4</sup>                             | 583,213 members | 87.73% of membership             |
| 2. Special Risk Class <sup>5</sup>                        | 72,078 members  | 10.84% of membership             |
| 3. Special Risk Administrative Support Class <sup>6</sup> | 74 members      | 0.01% of membership              |
| 4. Elected Officers' Class <sup>7</sup>                   | 2,195 members   | 0.33% of membership              |
| 5. Senior Management Service Class <sup>8</sup>           | 7,259 members   | 1.09% of membership <sup>9</sup> |

Each class is funded separately through an employer contribution of a percentage of the gross compensation of the member based on the costs attributable to members of that class and as provided in chapter 121, F.S.<sup>10</sup>

#### Special Risk Class

The Special Risk Class of the FRS was created to recognize that certain employees, because of the nature of the work they perform,<sup>11</sup> may need to retire at an earlier age with less service than other types of employees. As such, members of the Special Risk Class can retire at age 55 or with 25 years of creditable service.<sup>12</sup> Members of the Special Risk Class also earn a higher normal retirement benefit of

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<sup>1</sup> Section 121.025, F.S.

<sup>2</sup> FL. Dept. of Mgmt. Svcs., *Florida Division of Retirement Main Page* (visited Feb. 12, 2007) <[www.frs.state.fl.us](http://www.frs.state.fl.us)>

<sup>3</sup> *Id.*

<sup>4</sup> Section 121.021(12), F.S.

<sup>5</sup> Section 121.0515, F.S.

<sup>6</sup> Section 121.0515(7), F.S.

<sup>7</sup> Section 121.052, F.S.

<sup>8</sup> Section 121.055, F.S.

<sup>9</sup> Department of Management Services HB 521 (2007) Substantive Bill Analysis at 3. [hereafter referred to as DMS Analysis] (on file at dept. and the Committee on State Affairs)

<sup>10</sup> See, e.g., s. 121.055(3)(a)1., F.S.

<sup>11</sup> Section 125.0515(1), F.S. (work that is physically demanding or arduous, or work that requires extraordinary agility and mental acuity)

<sup>12</sup> Section 121.021(29), F.S., defines normal retirement date, which contrasts with members of the Regular Class who can retire at age 62 or with 30 years of creditable service.

three percent of the member's average final compensation.<sup>13</sup> These increased benefits are funded through higher employer contribution rates: 19.76 percent of gross compensation, effective July 1, 2006, and 21.96 percent, effective July 1, 2007.<sup>14</sup>

Special Risk Class membership includes: law enforcement officers, correctional officers, and firefighters;<sup>15</sup> emergency medical technicians and paramedics;<sup>16</sup> community-based correctional probation officers;<sup>17</sup> certain employees of correctional or forensic facilities or institutions;<sup>18</sup> youth custody officers;<sup>19</sup> and employees of a law enforcement agency or a medical examiner's office who are employed in a forensic discipline.<sup>20</sup>

### Retirement Benefit Calculation

The amount of benefits a retired member receives is based on three key factors: (1) years of service, (2) accrual rate (which is three percent for members of the Special Risk Class), and (3) the member's Average Final Compensation.<sup>21</sup> "Average Final Compensation" (AFC) is defined as the average of the five highest fiscal years of compensation for creditable service prior to retirement, termination, or death.<sup>22</sup>

Relevant to the definition of AFC is the definition of "compensation": the monthly salary a member is paid by his or her employer for work performed arising from that employment.<sup>23</sup> Compensation also includes overtime payments, accumulated annual leave payments, amounts withheld for tax sheltered annuities, deferred compensation programs, or any other type of salary reduction plan authorized under the Internal Revenue Code, and payments made in lieu of a permanent increase in the base rate of pay.<sup>24</sup> Bonuses, however, are specifically excluded from the definitions of compensation and AFC.<sup>25</sup>

### Proposed Changes

This bill expands the definition of compensation as it applies to firefighters, paramedics, and emergency medical technicians. It allows salary supplements received by a firefighter, paramedic, or emergency medical technician to be considered compensation, for retirement purposes, when said compensation is for employer-approved educational training or for other additional job-related duties and responsibilities.

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<sup>13</sup> Section 121.091(1)(a)2.h., F.S. (compared with 1.60 percent to 1.68 percent for Regular Class members).

<sup>14</sup> Section 121.71(3), F.S. (compared with 8.69 percent, effective July 1, 2006, and 9.55 percent effective July 1, 2007, for Regular Class members).

<sup>15</sup> Ch. 78-308, L.O.F.; codified as s. 121.0515, F.S.

<sup>16</sup> Ch. 99-392, L.O.F., s. 23.

<sup>17</sup> Ch. 2000-169, L.O.F., s. 29.

<sup>18</sup> *Id.* (The following employees must spend at least 75 percent of their time performing duties which involve contact with patients or inmates to qualify for the Special Risk Class: dietician; public health nutrition consultant; psychological specialist; psychologist; senior psychologist; regional mental health consultant; psychological services director-DRC; pharmacist; certain senior pharmacists; dentist; senior dentist; registered nurse; senior registered nurse; registered nurse specialist; clinical associate; advanced registered nurse practitioner; advanced registered nurse practitioner specialist; registered nurse supervisor; senior registered nurse supervisor; registered nursing consultant; quality management program supervisor; executive nursing director; speech and hearing therapist; and pharmacy manager)

<sup>19</sup> Ch. 2001-125, L.O.F., s. 43.

<sup>20</sup> Ch. 2005-167, L.O.F., s. 1; codified as s. 121.0515(2)(h), F.S. (The member's primary duties and responsibilities must include the collection, examination, preservation, documentation, preparation, or analysis of physical evidence or testimony, or both, or the member must be the direct supervisor, quality management supervisor, or command officer of one or more individuals with such responsibility; the forensic discipline must be recognized by the International Association for Identification and the member must qualify for active membership in the International Association for Identification).

<sup>21</sup> Section 121.091(1), F.S.

<sup>22</sup> Section 121.021(24), F.S.

<sup>23</sup> Section 121.021(22), F.S.

<sup>24</sup> *Id.*

<sup>25</sup> See ss. 121.021(22)(b)2. and (24)(b)4, F.S.

This expansion of the definition for compensation may likely result in a higher AFC, which would result in a higher retirement benefit for firefighters, paramedics, and emergency medical technicians who are compensated for such training or other additional job-related duties and responsibilities.

The Department of Management Services identified approximately 128 employers with approximately 10,950 employees that could be impacted by this bill. It is unknown how many agencies currently pay these types of supplemental payments, how many employees receive them, or the amount of such payments.<sup>26</sup>

C. SECTION DIRECTORY:

Section 1 amends s. 121.021, F.S., to revise the definition of "compensation."

Section 2 provides a declaration of important state interest.

Section 3 provides an effective date of July 1, 2007.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

Unknown, but insignificant. See fiscal comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

Unknown, but insignificant. See fiscal comments.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This bill does not appear to have a direct economic impact on the private sector.

D. FISCAL COMMENTS:

The Department of Management Services evaluated the fiscal impact of the bill and offered the following summation:

Under current law, the supplemental payments covered by this bill are not reported to the Division of Retirement, so the employer contribution portion of the cost impact cannot be directly determined from our records. Also, the language does not require employers to create new programs for these payments, only to report these payments as compensation [to] the FRS if they exist on or after July 1, 2007. Each impacted employer would pay an additional 20.92% of such payments to cover the contributions for the FRS benefit, PEORP administration fee, and the HIS.<sup>27</sup> We identified approximately 128 employers with at minimum of 10,950 employees who could have additional compensation reported to the FRS under HB 521.<sup>28</sup>

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<sup>26</sup> DMS Analysis at 2.

<sup>27</sup> HIS means health insurance subsidy.

<sup>28</sup> DMS Analysis at 6.

The Department of Management Services also provided the following fiscal note from the enrolled actuary:

Allowing nonrecurring payments to be treated as compensation that may be recognized in the calculation of retirement benefits<sup>29</sup> could lead to artificially inflated benefits. If benefit inflation occurs, it would be a source of actuarial losses which could lead to an increase in normal costs and unfunded actuarial liabilities, possibly resulting in higher contribution rates in the future for the FRS Special Risk Class. There would be a fiscal impact resulting from HB 521, but the nature and amount of these payments are not expected to be sufficient to require a specific increase in the Special Risk Class employer contribution rate to fund this proposal. Future actuarial experience studies and valuations of the FRS would reveal the impact, if any, of covering these payments as compensation for retirement purposes and be reflected in the contribution rate recommended by future valuations.<sup>30</sup>

### III. COMMENTS

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

This bill does not appear to reduce the percentage of a state tax shared with counties or municipalities. This bill does not appear to reduce the authority that counties or municipalities have to raise revenue.

This bill may, however, require counties or municipalities to spend funds or to take an action requiring the expenditure of funds. Yet, the bill appears to satisfy the requirements of s. 18, art. VII of the State Constitution because it provides that the act fulfills an important state interest and the expenditures are required by a law which appears to apply to all persons similarly situated, included the state and local governments.

##### 2. Other:

Article X, section 14 of the State Constitution provides that a governmental unit responsible for any retirement or pension system supported wholly or partially by public pension funds may not, after January 1, 1977, provide any increase in benefits to members or beneficiaries unless concurrent provisions for funding the increase in benefits are made on a sound actuarial basis.<sup>31</sup> According to the Department of Management Services, this bill complies with these requirements.<sup>32</sup>

#### B. RULE-MAKING AUTHORITY:

This bill does not appear to create, modify, or eliminate any rule-making authority.

#### C. DRAFTING ISSUES OR OTHER COMMENTS:

##### Other Comments: Possible policy change

As previously discussed, the definition of compensation specifically excludes bonuses,<sup>33</sup> which are payments made in addition to an employee's regular or overtime salary, are usually nonrecurring, do

<sup>29</sup> If any of the salaries from the five highest fiscal years include such payments, the payments would boost the member's initial benefit.

<sup>30</sup> *Id.* at 7.

<sup>31</sup> Part VII of chapter 112, F.S., the "Florida Protection of Public Employee Retirement Benefits Act," was adopted by the Legislature to implement the provisions of article X, section 14 of the Florida Constitution. This law establishes minimum standards for operating and funding public employee retirement systems and plans. This part is applicable to all units of state, county, special district, and municipal governments participating in or operating a retirement system for public employees that is funded in whole or in part by public funds.

<sup>32</sup> DMS Analysis at 7.

<sup>33</sup> Section 121.021(22)(b)2., F.S.

not increase the employee's base rate of pay, and include no commitment for payment in a subsequent year.<sup>34</sup> Furthermore, a payment is considered a "bonus" if any of the following applies:

- The payment is not made according to a formal written policy that applies to all eligible employees equally.
- The payment commences later than the 11th year of employment.
- The payment is not based on permanent eligibility.
- The payment is made less frequently than annually.<sup>35</sup>

Bonuses were originally included in the definitions of compensation and AFC. In 1984, the Legislature excluded bonuses from the definitions of AFC.<sup>36</sup> According to the Department of Management Services, the Legislature enacted this change in definition based upon recommendations from the consulting actuary and the Auditor General who sought to insure that promised benefits would be funded on a sound actuarial basis as required by the State Constitution. By excluding bonuses from consideration as compensation, retirement benefits would not be artificially inflated by payments at or near retirement that are not representative of the regular salary or regular payments received over a member's career. This way, unanticipated contribution rate increases are prevented and retirement benefits remain properly funded. In 1989, the Legislature excluded bonus payments from the definition of compensation;<sup>37</sup> thereby, making reported compensation consistent with compensation eligible for inclusion in a member's average final compensation.<sup>38</sup>

The Department of Management Services provided the following statement from the enrolled actuary regarding this bill:

HB 521 proposes to include salary supplements paid to firefighters, paramedics, and emergency medical technicians for successful completion of employer-approved educational training or for additional job-related duties and responsibilities as compensation for retirement purposes, without regard to the criteria described above. Employers would be required to make retirement contributions on such amounts just as they now make contributions based upon the employee's base pay. These changes would take effect July 1, 2007.

Under current law, payments made in addition to an employee's base rate of pay must be made according to a formal written policy that applies to all eligible employees equally, must be paid at least annually, and must continue for as long as the employee continues his or her employment in order to be considered compensation for retirement. Such payments may begin no later than the 11th year of employment. These provisions are designed to safeguard against "windfall" benefits.

To the extent that any of the salary supplements included in this bill can operate without the constraints listed above, they may operate like bonuses. Thus, the bill may create a policy change as it relates to bonuses as well as conflict between the definition of "compensation" and the definition of "bonuses."

#### Other Comments: Differential treatment of class members

This bill permits certain salary supplements to be "compensation" for retirement purposes only for firefighters, paramedics, or emergency medical technicians. Yet, the Special Risk Class also includes law enforcement officers, correctional officers, community-based correctional probation officers, youth custody officers, certain employees whose duties involve contact with patients or inmates in a correctional or forensic facility or institution, and employees of a law enforcement agency or medical examiner's office who are engaged in a forensic discipline.<sup>39</sup> It is not clear how the salary supplements

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<sup>34</sup> Section 121.021(47), F.S.

<sup>35</sup> *Id.*

<sup>36</sup> Ch. 84-266, L.O.F., revised the definition of "average final compensation" to exclude bonuses from coverage for retirement

<sup>37</sup> Ch. 89-126, L.O.F., revised the definition of "compensation" to exclude bonuses from consideration as compensation subject to retirement contributions.

<sup>38</sup> DMS Analysis at 5.

<sup>39</sup> Section 121.0515(2), F.S.

for firefighters, paramedics, or emergency medical technicians differ from those of the other Special Risk Class members, such that the salary supplements for one group are counted for retirement purposes, but not for the rest of the class.

D. STATEMENT OF THE SPONSOR

No statement submitted.

**IV. AMENDMENTS/COUNCIL SUBSTITUTE CHANGES**

Not applicable.