

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Governmental Operations Committee

BILL: PCS/CS/CS/SB 1428

INTRODUCER: General Government Appropriations Committee, Governmental Operations Committee and Senator Fasano

SUBJECT: Retirement

DATE: April 8, 2008

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Wilson</u>	<u>Wilson</u>	<u>GO</u>	<u>Fav/CS</u>
2.	<u>McVaney/Pigott</u>	<u>DeLoach</u>	<u>GA</u>	<u>Fav/CS</u>
3.	<u>Wilson</u>	<u>Wilson</u>	<u>GO</u>	<u>Pre-meeting</u>
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

Please see Section VIII. for Additional Information:

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|------------------------------|-------------------------------------|---|
| A. COMMITTEE SUBSTITUTE..... | <input checked="" type="checkbox"/> | Statement of Substantial Changes |
| B. AMENDMENTS..... | <input type="checkbox"/> | Technical amendments were recommended |
| | <input type="checkbox"/> | Amendments were recommended |
| | <input type="checkbox"/> | Significant amendments were recommended |

I. Summary:

The bill permits participants in the separately established optional retirement programs for the community colleges and universities to transfer to the Florida Retirement System (FRS) during a defined period of time. It also provides that participants in state university optional annuity retirement programs shall have that plan as their exclusive pension benefit choice and shall not be an FRS member.

The bill provides that FRS retirees re-employed after October 1, 2008, may not be renewed members of the system entitled to a second career benefit. The restriction extends to elected or appointed officers and to all other re-employed members after that date. Persons elected to retire, with or without DROP eligibility, prior to that date will be governed by the law in effect on September 30, 2008.

This bill substantially amends sections 121.021, 121.051, 121.35, and 121.355 of the Florida Statutes.

The bill creates section 121.355, Florida Statutes.

II. Present Situation:

Sections 121.35 and 1012.875, F.S., establish an optional retirement program for eligible participants employed by each of the 28 community colleges and 11 institutions in the state university system. Participants become eligible during the first 90 days of employment and must affirmatively elect participation. A failure to adhere to the time frames defaults to membership in the FRS.

There were 16,937 state university system active participants in the optional annuity program as of June 30, 2007, a nearly ten percent increase from that number two years earlier. Community college participants totaled 1,137 for this same period. Higher education hiring tends to be national and international in scope and participants favor pension arrangements in which their contracts are portable across many public and private pension jurisdictions.¹ The optional plans provide immediate vesting, unlike comparable state retirement plans which have vesting periods of one year for the defined contribution plan and six years for the defined benefit plan.

The 1997 Legislature created a Deferred Retirement Option Program (DROP) for officers and employees in the FRS. In such an arrangement, available only to participants in the defined benefit plan, a participant eligible for normal, unreduced benefits retires on paper. The person continues to work but has the remaining benefit of up to five years' service deposited in a separate interest-bearing account. At termination of employment, up to five years for most employees and eight for instructional personnel, the DROP balance is made available to the participant as either a full or partial distribution, or roll-over to another tax-sheltered retirement account.

The 2000 Legislature authorized the development of a defined contribution alternative to the principal benefit plan in which participants may elect to have an equity interest in their account which they must personally manage. DROP benefits are not included in this selection due to the incompatibility of design elements.

In the year 2001 and, again, in 2002, the Legislature enacted provisions that had the effect of permitting pension-eligible participants to retire, receive a DROP distribution, receive their monthly pension benefit, and then subsequently assume a new or their prior position to which they had been elected or employed. The 2002 amendments precluded simultaneous receipt of active and retired benefits when there was no practical interruption of office or employment. It curtailed the 2001 behavior but did not eliminate it.

Receiving more than one form of compensation for the same employment experience is referred in popular parlance as "double dipping" or "gaming the system." The "dip" is composed of the following elements: pension (dip one); subsequent salary (dip two); DROP benefits,² constructive or actual (dip three); and second career pension benefit (dip four). Additional benefit eligibility lawfully earned in other public jurisdictions - federal civilian or military

¹ The five approved annuity providers are: ING, TIAA-CREF (Teachers Insurance and Annuity Association-College Retirement Equities Fund), VALIC (Variable Annuity Life Insurance Company), Jefferson National Life Insurance Company, and MetLife Investors USA Insurance Company.

² It is technically not correct to assert that DROP is a separate "dip" as that is simply an equity partitioning of the original pension benefit. For practical purposes, however, it is reported as a distinguishable element in the behavior.

service, Social Security benefits, or employer-sponsored salary deferrals - may plausibly provide additional increments.

A series of news stories beginning in early 2008 by a state newspaper of daily circulation documented a number of elected and appointed officials and public employee members of the FRS that had constructed sequential careers with multiple benefit entitlements from the same employer or office. Salaries are public records and retirement records are no less so, although they must be retrieved one record at a time. The series of stories indicated that many officials rendered ineligible for some of the simultaneous benefits from the 2001 statute used provisions from the 2002 changes to achieve much the same result. A typical method of doing this is as follows: the official is reelected at the November ballot, resigns the following calendar month, and then assumes the reelected office on the succeeding January 1. The official has retired, terminated office, served the mandatory break-in-service of one calendar month, and reassumes covered employment or office during the next month. The official is then entitled to receive the salary for the new office, constructive, but not actual receipt, of the DROP benefit which continues to earn tax-sheltered interest at 6.5 percent per annum, and continues to serve in office. The news articles documented the prevalence of this practice among specifically named elected and appointed officials and other public employees in the FRS at all government levels. As a percentage of group membership judges specifically, and other criminal justice system officials generally, appeared to be the most common beneficiaries.

The Elected Officers' Class of the FRS, along with the Special Risk Retirement Class, have the highest accrual rates. They range from 3.00 percent to 3.33 percent per year of service. A circuit judge with thirty years of creditable service in that class who retires will receive one hundred percent of average final compensation as the nominal benefit. Subsequent participation in DROP for another sixty months will increase that monthly benefit by \$74,407 per \$1000 of initial monthly benefit. An Option One annual lifetime pension benefit of \$130,000, a DROP balance approaching \$1 million, and subsequent fixed compensation of \$140,000 is readily attainable.³

III. Effect of Proposed Changes:

The bill creates s. 121.355, F.S., to permit former participants in the Community College Optional Retirement Program and the State University Optional Retirement Program to transfer their membership to the Florida Retirement System during an election period commencing January 1, 2009, and ending December 31, 2009. The participant is responsible for the transfer of credit from the optional program, inclusive of any credits received under former membership in the FRS, and must replenish with personal funds any amount necessary to satisfy the actuarially determined amount. Amounts in excess of the required sums accrue to the participant.

The bill also amends three other sections of the retirement statutes to provide that faculty at a state academic college in a state university will be compulsory members in that university's optional annuity program established pursuant to s. 121.35, F.S. Participation will be governed by the terms of the contract between the participant and the provider company.

³ Option One is one of four defined benefit payment methods. It is a life annuity payable to the named participant and has no survivors' benefits.

FRS participants retiring effective October 1, 2008, who are subsequently reemployed shall not be enrolled in the Florida Retirement System.

The restriction extends to persons terminating DROP on that date if the person has been reemployed within ninety days of termination. In that circumstance the retirement will be deemed to have not occurred unless it was a leave of absence.

The reemployment restrictions extend to elected officers and is further augmented to restrict the payment of retirement benefits from the first career for the succeeding twelve months of reemployment. Elected officers concurrently employed in non-elected covered employment must terminate as provided in s. 121.021(39), F.S.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Since the bill requires the participant transferring to the FRS, and not the public employer, to make the pension plan financially whole when the benefit obligation is determined, there is no residual liability to the employer that would impair the full pension funding provisions of s. 14, Art. X of the State Constitution.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Eligible individuals seeking to make the change may have a surplus or deficit of personal financial assets in their optional accounts. If the amount is in excess of the liability, the remainder accrues to the participant. If a deficit results, the individual is personally responsible for the remaining amount.

The underlying participant contracts are deferred annuities, which are contracts for payment of benefits in installments for the life of the participant. These contracts have an accumulation phase, in which participant contributions are collected and proportionately

invested, and a distribution phase in which they are paid to the participant. Such contracts are invested long by the provider companies in anticipation that the participant will not make a claim until the expected date of retirement. When provider companies are presented with an account termination request they must liquidate their positions in assets that may not have yet reached their expected maturities. When a claim for payment or termination is presented sooner than assumed, the participant may deplete or liquidate the account only in several equal installments. A customary feature in such circumstances is to authorize a five to twenty percent transfer per calendar year without the imposition of a disintermediation or surrender fee. Full liquidation of account balances operates in a similar fashion. All such provisions are contractual between the participant and the provider company.

A participant chooses to transfer out of an optional annuity because the investment experience has not produced the expected income needed for retirement. This may be due to a variety of reasons: underinvestment, overinvestment, poor asset allocation, high account fees and expenses, or the unsuitability of this product to a participant's changed income needs.

There may be a hydraulic effect given the reduced inducements to return to covered employment. Employers or financial providers may find increased opportunities to sell what would be the equivalent of "gap" retirement benefits. The policies could be employer-sponsored and provide immediate annuity benefits only for the successive career now no longer eligible for supplemental FRS pension coverage.

The profile of the FRS membership is that of a forty-year-old plan with an average membership duration of twenty-one years, and an initial pension benefit of about \$1000 per month at first retirement. Most of the participants are women and the average salary in the Regular Class is about \$34,000. The effect of the interruption of the second career benefit may close off opportunities for the receipt of additional pension benefits that the income limits of the household may require for basic needs. At higher income limits this effect is less pronounced.

C. Government Sector Impact:

The fiscal effect of the reemployment restrictions will be experienced in subsequent valuations of the FRS. It has been the recent practice to commission such studies annually. The year 2008 conditions the start of an experience study, that is, a five-year valuation of the mortality and morbidity of the entire membership base. The results of this study will be delivered by the plan actuary to the Legislature at the end of the calendar year. The study will examine the membership as of June 30, 2008, and will not include any of the effects of the reemployment restrictions contained in this committee substitute. What can be assumed at present is that the direction of impact will be to eliminate payroll contribution amounts by FRS employers with re-employed participants after the effective date. This will operate as near-term operating budget savings. Over time in subsequent plan valuations it will migrate into reductions in over all system costs expressed as a percent of payroll contribution.

It can be expected that a relatively greater fiscal savings will be felt by the Elected Officers' Class. This is due to the higher payroll costs and the relatively greater incidence of class members engaging in this behavior. While overall numbers are higher in other classes, the nominal salaries and accrual rates are lower. Those savings may be smaller as a percent of payroll.

It is likely that participants otherwise eligible for normal benefits, with or without DROP, will view the October 1, 2008 deadline as an inducement to retire under the present law if they can persuade the present employer to reemploy them prior to September 30. The dynamics of choice will be the exact opposite for the employer as greater savings will accrue if a person is reemployed on October 1 or later.

Reemployed participants after October 1, 2008, will be ineligible for a second career benefit regardless of whether membership is sought in the defined benefit or defined contribution plan. Participants will also be denied eligibility, to the extent that they would otherwise have it, in the Senior Management Optional Annuity Program and the University/Community College Optional Annuity Program. The latter disqualification arises indirectly as it requires the member to transfer FRS membership if otherwise eligible for the base plan.

Supplemental benefit choices for the participant to augment the second career include:

- A. An employer-sponsored deferred compensation plan with or without an employer sponsored Deemed (sidecar) IRA or employer matching contribution.
- B. An individual or employer-sponsored immediate or deferred annuity.
- C. A self-directed individual retirement account established under various provisions of federal law.
- D. A simplified employee pension to the extent eligible under federal law and income limits.

The restrictions in the committee substitute operate to disqualify participants who return to an FRS employer in covered employment. This distinction is key because a number of individuals can avoid this restriction, even under current law, by returning as independent contractors. By law, contractors are not considered employees. To this extent, former employees may find this recourse a better alternative since they will have access to their suspended benefits after the first thirty days of termination from the prior position. It will further restrict them in terms of other workplace benefits, however, which will be denied them because they are an attribute of employment only. In such circumstances, the FRS employee will have to make arrangements for post-retirement health insurance, customarily payable at full cost less a health insurance subsidy.

For the purposes of describing the savings accruing to the public employer through the elimination of the second career benefit, the following are the employer-paid 2008 FRS contributions rates for the defined benefit and defined contribution plans:

FRS Employer Payroll Contribution Rates, 2008

Retirement Class	Defined Benefit [%]	Defined Contribution [%]
Regular	8.69	9.00
Special Risk	19.76	20.00
Special Risk, Admin.	11.39	11.35
Elected Officers, State	13.32	13.40
Elected Officers, Judges	18.40	18.90
Elected Officers, County	15.37	16.20
Senior Management	11.96	10.95
DROP	9.80	N/A

VI. Technical Deficiencies:

None.

VII. Related Issues:

The provisions for transfer of participation are located in two separate chapters of the Florida Statutes. Subsequent revisions of ch. 121, F.S., should consider a single location for these similar provisions to make their identification easier.

Section 121.051(2), F.S., governs optional participation in and withdrawal from the FRS for members of the community college and state university system. Generally, the conditions established under this section provided a time-limited transfer of credits under similar circumstances. A person who has terminated participation in one of the optional annuities and received a full or partial liquidation of the account balance may be disqualified from this process if there has been a distribution of the proceeds.

There are many individuals who choose to retire before receipt of normal, unreduced benefits. They may eventually return to covered FRS employment later in their lifetimes and pursue a second career. For such people the sanction on second career employment will prevent them from accruing any pension benefit approaching parity with their peers since that early retirement will permanently disqualify them from further benefit eligibility. This will pose a particular impact upon those atypically young or modestly compensated whose separation action may have been conditioned involuntarily, such as with an employer reduction-in-force or health needs. For still others in this situation this may constitute a social cost in which the subsequent lifetime disqualification will limit their ability of accruing any retirement income apart from Social Security benefits.

The original news stories documenting the reemployment behavior estimated the impact at some 400 elected and management officials and 7,700 employees statewide. On April 7, 2008, the State Board of Administration provided the committee with a results of a query on participants in the defined contribution plan. That report indicated that some 80 percent of reemployed Regular Class members established renewed membership in the Investment Plan. Three hundred forty

seven of the renewed members were under age 40. The Investment Plan vests members with a benefit at the end of one year of service compared with six years in the defined benefit plan.

VIII. Additional Information:

- A. **Committee Substitute – Statement of Substantial Changes:**
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by General Government Appropriations on March 26, 2008:

The bill clarifies that the eligibility to receive service credit is limited to mandatory members of the FRS defined benefit plan.

The bill prohibits a member from receiving service credit for the period in which the member was a mandatory member of the State University System Optional Retirement Program or for the period for which the member has received a distribution from the optional retirement programs.

CS by Governmental Operations on March 19, 2008:

Provides that university clinical faculty participating in a practice plan shall have the institution's optional annuity program as the exclusive pension choice. The terms of participation will be governed by the contractual provisions between the faculty members and the provider annuity company.

- B. **Amendments:**

Floor Amendment - Barcode 094278 on April 3, 2008:

The amendment provides that any officer or employee who retires and takes a pension distribution shall be ineligible to return to the prior office or position.