

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/CS/HB 1405 Retirement

**SPONSOR(S):** State Affairs Committee, Government Operations Subcommittee, Workman and others

**TIED BILLS:**           **IDEN./SIM. BILLS:** CS/SB 1130

| REFERENCE                             | ACTION           | ANALYST | STAFF DIRECTOR or<br>BUDGET/POLICY CHIEF |
|---------------------------------------|------------------|---------|--|
| 1) Government Operations Subcommittee | 9 Y, 5 N, As CS  | Meadows | Williamson                               |
| 2) State Affairs Committee            | 13 Y, 6 N, As CS | Meadows | Hamby                                    |
| 3) Appropriations Committee           | 15 Y, 8 N        | Delaney | Leznoff                                  |

### SUMMARY ANALYSIS

The Florida Retirement System (FRS) is a multi-employer, non-contributory plan that provides retirement income benefits to 655,367 active members, 304,337 retired members and beneficiaries, and 33,577 members of the Deferred Retirement Option Program. It 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 182 cities and 231 independent special districts that have elected to join the system.

Members of the FRS have two plan options available for participation: the defined benefit plan, also known as the pension plan; and the defined contribution plan, also known as the investment plan.

This bill makes several changes to the FRS; however, changes impacting member benefits do not apply to those persons who have already retired from FRS employment. Benefits already earned are not impacted by the changes in this bill.

The bill changes the name of the FRS defined benefit program to the Florida Retirement System Pension Plan (pension plan). It also changes the name of the defined contribution program from the Public Employee Optional Retirement Program to the Florida Retirement System Investment Plan (investment plan).

Effective July 1, 2011, the bill:

- Requires a 3 percent employee contribution for members of all classes of the FRS pension plan and investment plan.
- Closes the Deferred Retirement Option Program to new participants.
- Increases the retirement age and years of service for members of the FRS who initially enroll on or after July 1, 2011.

The bill has a significant fiscal impact on state and local governments (710.5 million in General Revenue, \$1.1 billion for all participating entities.) See Fiscal Comments section for further discussion.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### Background

###### Florida Retirement System

The Florida Retirement System (FRS) was established in 1970 when the Legislature consolidated the Teachers' Retirement System, the State and County Officers and Employees' Retirement System, and the Highway Patrol Pension Fund. In 1972, the Judicial Retirement System was consolidated into the pension plan, and in 2007, the Institute of Food and Agricultural Sciences Supplemental Retirement Program was consolidated under the Regular Class of the FRS as a closed group.<sup>1</sup> Prior to 1975, members of the FRS were required to make employee contributions. Regular Class members contributed 4 percent of their salary while Special Risk Class members contributed 6 percent.

Today, the Florida Retirement System Act<sup>2</sup> governs the FRS, which is a multi-employer, non-contributory plan that provides retirement income benefits to 655,367 active members,<sup>3</sup> 304,337 retired members and beneficiaries,<sup>4</sup> and 33,577 members of the Deferred Retirement Option Program.<sup>5</sup> It 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 182 cities and 231 independent special districts that have elected to join the system.<sup>6</sup>

The membership of the FRS is divided into five membership classes:

- Regular Class<sup>7</sup> consists of 570,198 members (87.00 percent of the membership);
- Special Risk Class<sup>8</sup> includes 75,066 members (11.46 percent);
- Special Risk Administrative Support Class<sup>9</sup> has 71 members (0.01 percent);
- Elected Officers' Class<sup>10</sup> has 2,284 members (0.35 percent); and
- Senior Management Service Class<sup>11</sup> has 7,748 members (1.18 percent).<sup>12</sup>

Each class is funded separately based upon the costs attributable to the members of that class.

Members of the FRS have two plan options available for participation:

- The defined benefit plan, also known as the pension plan; and
- The defined contribution plan, also known as the investment plan.

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<sup>1</sup> The Florida Retirement System Annual Report, July 1, 2009 – June 30, 2010, at 60.

<sup>2</sup> Chapter 121, F.S.

<sup>3</sup> As of June 30, 2010, the FRS defined benefit plan, also known as the pension plan, had 557,585 members, and the defined contribution plan, also known as the investment plan, had 97,782 members. The Florida Retirement System Annual Report, July 1, 2009 – June 30, 2010, at 1 and 43.

<sup>4</sup> *Id.* at 52.

<sup>5</sup> *Id.* at 1.

<sup>6</sup> *Id.* at 92.

<sup>7</sup> Regular Class members are those members who do not qualify for membership in the other classes within the FRS. *See s.* 121.021(12), F.S.

<sup>8</sup> Members include law enforcement officers, firefighters, correctional officers, correctional probation officers, paramedics, emergency medical technicians, certain professional health care workers within the Department of Corrections and the Department of Children and Family Services, and certain forensic employees. *See s.* 121.0515, F.S.

<sup>9</sup> Members are former members of the special risk class who are transferred or reassigned to an administrative support position in certain circumstances. *See s.* 121.0515(7), F.S.

<sup>10</sup> Membership is comprised of those participants who hold specified elective offices in either state or local government. *See s.* 121.052, F.S.

<sup>11</sup> Members generally are high level executive and legal staff or as specifically provided in law. *See s.* 121.055, F.S.

<sup>12</sup> Substantive analysis of HB 1405, Department of Management Services, March 15, 2011, at 3 (on file with the Government Operations Subcommittee).

### Investment Plan

In 2000, the Legislature created the Public Employee Optional Retirement Program (investment plan),<sup>13</sup> a defined contribution plan offered to eligible employees as an alternative to the FRS pension plan. The earliest that any member could participate in the investment plan was July 1, 2002.

Benefits under the investment plan accrue in individual member accounts funded entirely by employer contributions and earnings.<sup>14</sup> Benefits are provided through employee-directed investments offered by approved investment providers.

A member vests in the investment plan after completing one work year with an FRS employer.<sup>15</sup> Vested benefits are payable upon termination or death as a lump-sum distribution, direct rollover distribution, or periodic distribution. In addition to normal benefits and death benefits, the investment plan also provides disability coverage.<sup>16</sup>

The State Board of Administration (SBA) is primarily responsible for administering the investment plan.<sup>17</sup> The SBA is comprised of the Governor as chair, the Chief Financial Officer, and the Attorney General.<sup>18</sup>

### Pension Plan

The pension plan is administered by the secretary of the Department of Management Services through the Division of Retirement.<sup>19</sup> Investment management is handled by the State Board of Administration.

A member vests in the pension plan after completing six years of service with an FRS employer.<sup>20</sup> Benefits payable under the pension plan are calculated based on years of service X accrual rate X average final compensation.<sup>21</sup> For most members of the pension plan, normal retirement occurs at the earlier attainment of 30 years of service or age 62.<sup>22</sup> For public safety employees in the Special Risk and Special Risk Administrative Support Classes, normal retirement is the earlier attainment of 25 years of service or age 55.<sup>23</sup>

### Optional Retirement Programs

Eligible employees may choose to participate in one of three optional retirement programs instead of participating in the FRS:

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<sup>13</sup> Part II, chapter 121, F.S.

<sup>14</sup> Section 121.4501(7), F.S.

<sup>15</sup> Section 121.4501(6)(a), F.S.

<sup>16</sup> See s. 121.4501, F.S.

<sup>17</sup> See s. 121.4501(8), F.S.

<sup>18</sup> Established by Article IV, s. 4(e) of the State Constitution.

<sup>19</sup> Section 121.025, F.S.

<sup>20</sup> Section 121.021(45), F.S.

<sup>21</sup> Section 121.021(23), F.S., defines "average final compensation to mean:

[T]he average of the 5 highest fiscal years of compensation for creditable service prior to retirement, termination, or death. For in-line-of-duty disability benefits, if less than 5 years of creditable service have been completed, the term "average final compensation" means the average annual compensation of the total number of years of creditable service. Each year used in the calculation of average final compensation shall commence on July 1.

(a) The average final compensation shall include:

1. Accumulated annual leave payments, not to exceed 500 hours; and
2. All payments defined as compensation in subsection (22).

(b) The average final compensation shall not include:

1. Compensation paid to professional persons for special or particular services;
2. Payments for accumulated sick leave made due to retirement or termination;
3. Payments for accumulated annual leave in excess of 500 hours;
4. Bonuses as defined in subsection (47);
5. Third party payments made on and after July 1, 1990; or
6. Fringe benefits (for example, automobile allowances or housing allowances).

<sup>22</sup> Section 121.021(29)(a), F.S.

<sup>23</sup> Section 121.021(29)(b), F.S.

- Members of the Senior Management Service Class may elect to enroll in the Senior Management Service Optional Annuity Program.<sup>24</sup>
- Members in specified positions in the State University System may elect to enroll in the State University System Optional Retirement Program.<sup>25</sup>
- Members of a Florida college may elect to enroll in the State Community College System Optional Retirement Program.<sup>26</sup>

#### Normal Retirement Date

Pursuant to current law, members of the Special Risk Class and Special Risk Administrative Support Class reach normal retirement date when they attain six or more years of creditable service and 55 years of age, or complete 25 years of creditable service. Members of all other classes reach normal retirement date when they attain six or more years of creditable service and 62 years of age, or 30 years of creditable service.<sup>27</sup>

#### Service Accrual Rate

Members earn retirement credit for each year of covered service at different rates depending on their membership class at the time of such service. The FRS service accrual rates are as follows:<sup>28</sup>

| <b>Membership Class</b>                   | <b>Service Accrual Rate</b>   |
|---|-------------------------------|
| Special Risk Class                        | 3.00%                         |
| Special Risk Administrative Support Class | 1.60%, 1.63%, 1.65%, or 1.68% |
| Elected Officers' Class                   |                               |
| • Justices and Judges                     | 3.33%                         |
| • All others                              | 3.00%                         |
| Senior Management Service Class           | 2.00%                         |
| Regular Class                             | 1.60%, 1.63%, 1.65%, or 1.68% |

#### Contribution Rates

FRS employers are responsible for contributing a set percentage of the member's monthly compensation to the Division of Retirement to be distributed into the FRS Contributions Clearing Trust Fund.<sup>29</sup> The employer contribution rate is a "blended contribution rate" set by statute, which is the same percentage regardless of whether the member participates in the pension plan or the investment plan. The rate is determined annually based on an actuarial study by the Department of Management Services that calculates the necessary level of funding to support all of the benefit obligations under both FRS retirement plans.<sup>30</sup>

The following are the current employer contribution rates for each class:<sup>31</sup>

| <b>Membership Class</b>  | <b>Effective July 1, 2010</b> |
|--|-------------------------------|
| Regular Class  | 9.63%                         |
| Special Risk Class   | 22.11%                        |
| Special Risk Administrative Support Class  | 12.10%                        |
| Elected Officers' Class  |                               |
| • Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders | 15.20%                        |
| • Justices and Judges  | 20.65%                        |
| • County Officers  | 17.50%                        |

<sup>24</sup> Section 121.055(6), F.S.

<sup>25</sup> Section 121.35, F.S.

<sup>26</sup> Section 1012.875, F.S.

<sup>27</sup> Section 121.021(29), F.S.

<sup>28</sup> Section 121.091, F.S.

<sup>29</sup> Section 121.78, F.S.

<sup>30</sup> See ss. 121.031 and 121.71, F.S.

<sup>31</sup> Section 121.71(3), F.S.

| Membership Class                | Effective<br>July 1, 2010 |
|---------------------------------|---------------------------|
| Senior Management Service Class | 13.43%                    |

After employer contributions are placed into the FRS Contributions Clearing Trust Fund, benefits under the investment plan are transferred to third-party administrators to be placed in the employee's individual investment accounts, whereas benefits under the pension plan are placed into the FRS Trust Fund.<sup>32</sup>

#### Deferred Retirement Option Program

The Deferred Retirement Option Program (DROP) allows a member of the pension plan to retire while continuing employment for up to 60 months. Certain instructional personnel may participate in DROP up to an additional 36 months. While in DROP, the member's retirement benefits accumulate in the FRS Trust Fund, increased by a cost of living adjustment each July, and earn a monthly interest equivalent to an annual rate of 6.50 percent. Upon termination, the member receives a lump sum DROP payment as a direct payment, a rollover, or a combination partial lump sum payment and rollover.<sup>33</sup>

#### Retiree Health Insurance Subsidy

Current law provides a retiree health insurance subsidy to assist retirees of all state-administered pension plan systems in paying health insurance costs. An eligible retiree currently receives an extra \$5 per month for each year of creditable service completed at retirement, with a minimum monthly payment of \$30 and a maximum monthly payment of \$150. A retiree must satisfy the vesting requirements for his or her membership class, unless that person retired due to an in-line-of-duty disability, in order to receive the health insurance subsidy. Also, the retiree must have proof of coverage for eligibility to receive such subsidy.<sup>34</sup>

#### **Effect of the Bill**

The bill makes several changes to the FRS; however, changes impacting member benefits do not apply to those persons who have already retired from FRS employment. Benefits already earned are not impacted by the changes in this bill.

#### Overview

The bill changes the name of the FRS defined benefit program to the Florida Retirement System Pension Plan (pension plan). It also changes the name of the defined contribution program from the Public Employee Optional Retirement Program to the Florida Retirement System Investment Plan (investment plan).

Effective July 1, 2011, the bill:

- Requires a 3 percent employee contribution for members of all classes of the FRS pension plan and investment plan.
- Closes DROP to new participants.
- Increases the retirement age and years of service for members of the FRS who initially enroll on or after July 1, 2011.

#### Contributions, Generally

The bill defines the terms "participant contributions," "member contributions," and/or "employee contributions." These contributions are defined as the sum of all amounts deducted from the salary of a member and credited to the member's individual investment accounts by the employer in accordance with s. 121.71(2), F.S. The contributions also include any earnings on these amounts and any other contributions as specified.

<sup>32</sup> See ss. 121.4503 and 121.72, F.S.

<sup>33</sup> See s. 121.091(13), F.S.

<sup>34</sup> See s. 112.363, F.S.

### Employee Contributions

The bill requires each member of the FRS to contribute 3 percent of his or her gross compensation to the FRS, prior to federal tax withholdings. The contribution is treated as an employer-paid employee contribution. The member must consent to the deduction as a condition of employment. A member is fully and immediately vested in all employee contributions paid to the investment plan or pension plan, plus interest and earnings thereon.

The bill specifies that if a member terminates employment for three consecutive months for any reason, other than retirement, the member is eligible for a refund in the amount of his or her accumulated contributions as of the date of termination. If a member elects to receive a refund, he or she is considered to have waived all rights under the FRS and to the health insurance subsidy; however, the member does retain the right to purchase his or her prior service credit in accordance with chapter 121, F.S. The refund may not include any interest that the contributions earned, and employer contributions made on behalf of the member are not refundable. A partial refund is prohibited, and a member may not receive a refund if there is a pending or approved qualified domestic relations order filed against the member's account.

The bill amends s. 121.4501, F.S., to provide that a member of the pension plan who chooses to take a refund of employee contributions on or after July 1, 2011, retains his or her prior plan choice upon returning to employment with an FRS employer.

If a member chooses to switch from the pension plan to the investment plan, then a refund is not permitted for any employee contributions or additional payments which exceed the employee contributions that would have accrued had the member remained in the pension plan and not transferred to the investment plan. The same applies for a member who chooses to switch from the investment plan to the pension plan.

If a member chooses to switch retirement plans and contribution adjustments are required due to employer errors or corrections, the member is entitled to the additional contributions. However, the member is responsible for returning any excess contributions resulting from the correction. This return must be made within the period allowed by the United States Internal Revenue Service. The present value of the member's accumulated benefit remains the same.

The bill also provides for a procedure for the repayment of an invalid refund. If a member receives an invalid refund, the member must repay the amount of the invalid refund plus 6.5 percent interest compounded annually on June 30 from the date of the refund until the invalid refund is fully satisfied. The invalid refund must be repaid before the member retires or transfers to the investment plan.

### Employer Contributions

The bill also establishes employer contribution rates as follows:

| <b>Membership Class</b>  | <b>Effective<br/>July 1, 2011</b> | <b>Effective<br/>July 1, 2012</b> |
|--|-----------------------------------|-----------------------------------|
| Regular Class  | 6.16%                             | 6.16%                             |
| Special Risk Class   | 16.95%                            | 16.95%                            |
| Special Risk Administrative Support Class  | 7.23%                             | 7.23%                             |
| Elected Officer's Class  |                                   |                                   |
| • Legislators, Governor, Lt. Governor,<br>Cabinet Officers, State Attorneys, Public<br>Defenders | 10.76%                            | 10.76%                            |
| • Justices and Judges  | 15.19%                            | 15.19%                            |
| • County Officers  | 13.08%                            | 13.08%                            |
| Senior Management Service Class  | 8.14%                             | 8.14%                             |
| Deferred Retirement Option Program (DROP)  | 3.50%                             | 3.50%                             |

### Unfunded Actuarial Liability

The bill also establishes additional employer contribution rates for the purpose of funding the unfunded actuarial liabilities. Those contributions are as follows:

| <b>Membership Class</b>  | <b>Effective<br/>July 1, 2011</b> | <b>Effective<br/>July 1, 2012</b> |
|--|-----------------------------------|-----------------------------------|
| Regular Class  | 0.25%                             | 2.06%                             |
| Special Risk Class   | 1.17%                             | 6.88%                             |
| Special Risk Administrative Support Class  | 0.59%                             | 20.13%                            |
| Elected Officer's Class  |                                   |                                   |
| • Legislators, Governor, Lt. Governor,<br>Cabinet Officers, State Attorneys, Public<br>Defenders | 0.51%                             | 20.55%                            |
| • Justices and Judges  | 0.39%                             | 12.05%                            |
| • County Officers  | 0.42%                             | 20.70%                            |
| Senior Management Service Class  | 0.05%                             | 10.00%                            |
| Deferred Retirement Option Program (DROP)  | 0.00%                             | 4.76%                             |

### Normal Retirement Date

The bill revises the normal retirement date for any member *initially* enrolled in the FRS on or after July 1, 2011. Effective July 1, 2011, the bill increases the retirement age and years of service for new members of the Special Risk Class and the Special Risk Administrative Support Class as follows:

- Increases the age from 55 to 60 years of age; and
- Increases the years of creditable service from 25 to 30 years.

It also increases the retirement age and years of service for new members in all other classes as follows:

- Increases the age from 62 to 65 years of age; and
- Increases the years of creditable service from 30 to 33 years.

A member only needs to obtain one of the requirements, either the retirement age or the years of creditable service. The change in normal retirement date *does not apply* to members enrolled in the FRS prior to July 1, 2011.

### Special Risk Class

The bill relocates the membership requirements for qualification in the Special Risk Class from the definition section to the section of law relating to special risk class membership. It also revises the procedure for applying for designation as a member of the Special Risk Class.

An employee seeking to have his or her position designated as a Special Risk Class position must request the employer to complete an Application for Special Risk Membership provided in Form FRS-400 or Form FRS-405. The employer must submit a copy of the job description of the member's duties and a breakdown of the percentage of time spent performing such duties. Additionally, a personnel action form must be submitted that shows an effective date for membership in that position. The Department of Management Services must review the application and either approve or disapprove the application for Special Risk Class membership. If the employer refuses to certify the application for Special Risk Class membership, the employer is required to notify the member of the refusal and state the reasons for refusal.

The bill also provides that any member who is a Special Risk Class member and who fails to meet the Special Risk Class criteria must have his or her Special Risk Class designation removed and thereafter be moved to the Regular Class. The Department of Management Services has the ability to review the Special Risk Class designation of a member to determine whether or not the member continues to meet the criteria for the Special Risk Class.

### Incorrect Membership Classification

The bill amends section 121.71(6), F.S., to provide that if a member is reported to FRS under an incorrect membership by the employer and the contribution is less than the requirement, the employer must pay the difference, plus a delinquent fee of 1 percent for each calendar month, or part thereof, that the contribution should have been made. If the contribution is more than the required contribution, the employer shall receive a credit toward future contributions.

### Deferred Retirement Option Program

Effective July 1, 2011, the bill closes DROP to new participants; however, any member entering DROP prior to that date may continue participation in DROP until completion.

### Payment of Benefits

Under the investment plan, Senior Management Service Optional Annuity Program, State University System Optional Retirement Program, or State Community College System Optional Retirement Program, the bill prohibits the payment of benefits before termination of employment in certain instances. Benefits may not be payable for employee hardships, unforeseeable emergencies, loans, medical expenses, educational expenses, purchase of a principal residence, payments necessary to prevent eviction or foreclosure on an employee's principal residence, or any other reason prior to termination from all employment relationships with participating employers.

### Miscellaneous Provisions

The bill provides a statement of important state interest. It also directs the State Board of Administration and the Department of Management Services to request a private letter ruling and determination letter from the Federal Internal Revenue Service (IRS) upon the bill becoming a law. If the IRS refuses to act on the private letter ruling request, a legal opinion from a tax attorney can be substituted. It also provides that if any portion of the bill would cause the FRS to be disqualified for tax purposes under the Internal Revenue Code, then that portion of the bill would not apply. The State Board of Administration and the Department of Management Services must notify the Legislature if any portion of the bill cannot be implemented.

## B. SECTION DIRECTORY:

Section 1 amends s. 110.123, F.S., to make conforming changes.

Section 2 amends s. 112.363, F.S., to make conforming changes.

Section 3 amends s. 112.65, F.S., to make conforming changes.

Section 4 amends s. 121.021, F.S., to revise definitions.

Section 5 amends s. 121.051, F.S., to require a local governmental entity or the governing body of a charter school or charter technical career center to make certain elections regarding benefits at the time of joining the FRS; to provide that employer-paid employee contributions are subject to certain taxes.

Section 6 amends s. 121.0515, F.S., to modify the qualifications and criteria for membership in the Special Risk Class; to provide procedures for designation and removal of designation of Special Risk Class membership; to provide that employee contributions are to be used, if applicable, when purchasing credit for past service.

Section 7 amends s. 121.052, F.S., to revise provisions related to the Elected Officers' Class; to make conforming changes; to require member contributions; to provide for a refund of contributions under certain circumstances for an officer who leaves office; to provide that a member who obtains a refund of contributions waives certain rights.

Section 8 amends s. 121.053, F.S., to clarify the employer contributions required for Elected Officers' Class members who participate in DROP.



Section 9 amends s. 121.055, F.S., to revise provisions related to the Senior Management Service Class; to make conforming changes; to require employee contributions; to provide for a refund of contributions under certain circumstances for a member who terminates employment; to provide that a member who obtains a refund of contributions waives certain rights under the FRS.

Section 10 amends s. 121.071, F.S., to require employer and employee contributions to the retirement system effective July 1, 2011; to provide for a refund of contributions under certain circumstances following termination of employment; to prohibit such refund if an approved qualified domestic relations order is filed against the member's account; to require repayment plus interest of an invalid refund.

Section 11 amends s. 121.081, F.S., to provide and revise certain requirements for contributions for prior service performed on or after July 1, 2011.

Section 12 amends s. 121.091, F.S., to modify the monthly benefit calculation for those members retiring on or after July 1, 2011, to reflect the change in normal retirement age; to provide for the refund of accumulated contributions if a member's employment is terminated for any reason other than retirement; to close DROP to new participants on July 1, 2011.

Section 13 amends s. 121.121, F.S., to modify provisions related to the purchase of creditable service following an authorized leave of absence; to require that service credit be purchased at the employee and employer contribution rates in effect during the leave of absence.

Section 14 amends s. 121.125, F.S., to require that certain employers make the required employee and employer contributions following an employee's workers' compensation injury or illness; to require that a penalty be assessed against certain employers that fail to pay the required contributions.

Section 15 reenacts s. 121.161, F.S., which relates to references of other laws as amended.

Section 16 amends s. 121.35, F.S., to limit the payment of benefits prior to a participant's termination of employment under the optional retirement program for the State University System.

Section 17 amends s. 121.4501, F.S., to change the name of the Public Employee Optional Retirement Program to the FRS Investment Plan; to require members of the investment plan to make certain contributions to the FRS Investment Plan Trust Fund based on the employee's membership class; to revise and provide definitions; to revise the benefit commencement age for a member enrolled on or after July 1, 2011; to provide for contribution adjustments as a result of employer errors or corrections; to require an employer to receive a credit for excess contributions and to reimburse an employee for excess contributions, subject to certain limitations; to provide for a pension plan participant to retain his or her prior plan choice following a return to employment; to limit certain refunds of contributions that exceed the amount that would have accrued had the member remained in the defined benefit program; to provide certain requirements and limitations with respect to contributions; to clarify that participant and employer contributions are earmarked for specified purposes; to provide duties of the third-party administrator; to provide that a member is fully and immediately vested with respect to employee contributions paid by the member; to provide for forfeiture of nonvested employer contributions and service credit under certain circumstances.

Section 18 amends s. 121.4502, F.S., to change the name of the Public Employee Optional Retirement Program Trust Fund to the FRS Investment Plan Trust Fund.

Section 19 amends s. 121.4503, F.S., to provide for deposit of participant contributions into the FRS Contributions Clearing Trust Fund.

Section 20 amends s. 121.571, F.S., to provide the requirements for submitting employee contributions.

Section 21 amends s. 121.591, F.S., to limit the payment of benefits prior to a participant's termination of employment; to provide for forfeiture of nonvested accumulations and service credits upon payment of certain vested benefits; to provide that the distribution payment method selected by the participant or

beneficiary is final and irrevocable at the time of benefit distribution; to prohibit a distribution of employee contributions if a qualified domestic relations order is filed against the participant's account.

Section 22 amends s. 121.5911, F.S., to make conforming changes.

Section 23 amends s. 121.70, F.S., to revise legislative intent.

Section 24 amends s. 121.71, F.S., to require that employee contributions be deducted from the employee's monthly salary, beginning on a specified date, and treated as employer contributions under certain provisions of federal law; to clarify that an employee may not receive such contributions directly; to specify the required employee and employer retirement contribution rates for the membership of each class and subclass of the FRS; to specify the required employer retirement contribution rates for each membership class and subclass of the FRS in order to address unfunded actuarial liabilities of the system; to require an assessment to be imposed if the employee contributions remitted are less than the amount required under certain circumstances; to provide for the employer to receive a credit for excess contributions remitted and to apply such credit against future contributions owed.

Section 25 amends s. 121.72, F.S., to make conforming changes.

Section 26 amends s. 121.73, F.S., to make conforming changes.

Section 27 amends s. 121.74, F.S., to make conforming changes.

Section 28 amends s. 121.75, F.S., to make conforming changes.

Section 29 amends s. 121.77, F.S., to make conforming changes.

Section 30 amends s. 121.78, F.S., to revise certain requirements for administering the payment and distribution of contributions; to require certain fees be imposed for delinquent payments; to provide that an employer is responsible for recovering any refund provided to an employee in error; to revise the terms of an authorized waiver of delinquency; to require an employer to receive a credit for excess contributions and to reimburse an employee for excess contributions, subject to certain limitations.

Section 31 requires the SBA and the Department of Management Services to request a determination letter and a private letter ruling from the United State Internal Revenue Service; to provide for severability.

Section 32 provides legislative findings and provides that the act fulfills an important state interest.

Section 33 provides appropriations to and authorizes additional positions for the Division of Retirement within the Department of Management Services.

Section 34 provides an effective date of July 1, 2011, unless otherwise expressly provided in the act.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

### **A. FISCAL IMPACT ON STATE GOVERNMENT:**

#### **1. Revenues:**

See Fiscal Comments section.

#### **2. Expenditures:**

See Fiscal Comments section.

### **B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

1. Revenues:  
See Fiscal Comments section.

2. Expenditures:  
See Fiscal Comments section.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:  
None.

D. FISCAL COMMENTS:

For fiscal year 2011-2012, the bill appropriates \$207,070 of recurring funds and \$31,184 of non-recurring funds from the Florida Retirement System Operating Trust Fund to the Division of Retirement within the Department of Management Services for the purpose of implementing this act. It also authorizes four full-time equivalent positions for the Division to implement this act.

Actuarial studies have been performed to determine the cost savings associated with requiring a 5 percent employee contribution rate, closing DROP, and increasing the normal retirement date. The actuary also provided figures for requiring a 3 percent employee contribution rate based upon the 5 percent contribution study. The cost savings are as follows:

| <b>Entities Funded by the State</b>           | <b>General Revenue</b> | <b>Trust Fund</b>     |
|---|------------------------|-----------------------|
| State   | \$109.3 million        | \$98.9 million        |
| County School Boards                          | \$521.2 million        |                       |
| State Universities                            | \$43.9 million         |                       |
| State Colleges                                | \$36.1 million         |                       |
| <i>Total</i>                                  | <i>\$710.5 million</i> | <i>\$98.9 million</i> |
| <b>Other Entities Not Funded by the State</b> |                        |                       |
| Counties                                      | \$333.4 million        |                       |
| Municipalities / Other                        | \$63.5 million         |                       |
| <i>Grand Total</i>                            | <i>\$1.1 billion</i>   | <i>\$98.9 million</i> |

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision appears to apply because this bill requires cities and/or counties to spend money or take action that requires the expenditure of money; however an exception applies as the Legislature has determined that this bill satisfies an important state interest. In addition, similarly situated persons are all required to comply.

2. Other:

Actuarial Requirements

Article X, s. 14 of the State Constitution requires that benefit improvements under public pension plans in the State of Florida be concurrently funded on a sound actuarial basis, as set forth below:

SECTION 14. State retirement systems benefit changes.--A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not after January 1, 1977, provide any increase in the benefits

to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis.

Article X, s. 14 of the State Constitution is implemented by statute under part VII of chapter 112, F.S., the “Florida Protection of Public Employee Retirement Benefits Act” (Act). The Act establishes minimum standards for the operation and funding of public employee retirement systems and plans in the State of Florida. It prohibits the use of any procedure, methodology, or assumptions the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers.

This bill appears to meet the requirements of Article X, s. 14 of the State Constitution; however, it is unclear as to whether it is in compliance with the requirements of part VII of chapter 112, F.S.

#### Contractual Obligations

Article I, s. 10 of the State Constitution prohibits any bill of attainder, ex post facto law, or law impairing the obligation of contracts from being passed by the Florida Legislature.

The Florida Statutes provide that the rights of members of the FRS are of a contractual nature, entered into between the member and the state, and such rights are legally enforceable as valid contractual rights and may not be abridged in any way.<sup>35</sup> This “preservation of rights” provision<sup>36</sup> was established by the Florida Legislature with an effective date of July 1, 1974.

The Florida Supreme Court has held that the Florida Legislature may only alter the benefits structure of the FRS prospectively.<sup>37</sup> The prospective application would only alter future benefits. Those benefits previously earned or accrued by the member, under the previous benefit structure, remain untouched and the member continues to enjoy that level of benefit for the period of time up until the effective date of the proposed changes. Further, once the participating member reaches retirement status, the benefits under the terms of the FRS in effect at the time of the member’s retirement vest.<sup>38</sup>

The Florida Supreme Court further held that the “preservation of rights” provision was not intended to bind future legislatures from prospectively altering benefits which accrue for future state service.<sup>39</sup>

This bill does not change any benefits that a member has earned prior to July 1, 2011. The bill only makes changes prospectively. As such, it does not appear to impair the contractual obligation between the FRS employer and the FRS member.

#### B. RULE-MAKING AUTHORITY:

The bill does not appear to authorize nor require any additional grants of rulemaking authority.

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

The Department of Management Services provided the following statement regarding recommended changes:<sup>40</sup>

- To make the FRS an employee contributory program, the additional sections of chapter 121, F.S. need to be amended:
  - ✓ 121.051(2)(c)6a and 6b – CCORP

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<sup>35</sup> Section 121.011(3)(d), F.S.

<sup>36</sup> The “preservation of rights” provision vests all rights and benefits already earned under the present retirement plan so the legislature may now only alter the benefits prospectively. *Florida Sheriffs Association v. Department of Administration, Division of Retirement*, 408 So.2d 1033, 1037 (Fla. 1981).

<sup>37</sup> *Id.* at 1035.

<sup>38</sup> *Id.* at 1036. See also Internal Revenue Code, s. 441(e)(2) and Rev. Rul. 69-421, Part 5.

<sup>39</sup> *Id.* at 1037.

<sup>40</sup> Email to Committee staff from Sarabeth Snuggs, Director of the Division of Retirement, March 24, 2011 (on file with the State Affairs Committee).

- ✓ 121.052(4)(a), (b), (d)1 and (5)(d) – Elected Officers' serving shortened terms
- ✓ 121.055(6)(a) – SMSOAP
- ✓ 121.591(2)(m)2a – Disabled Justices and Judges
- 1012.875 – need to add language not allowing loans and hardships for CCORP (for consistency with all other plans which have this language in the bill)
- 121.0515(10)(c) – Line 1145 – Page 42 June 30, 2005 should be changed to June 30, 2008
- 121.4501(20) – Line 3698 – Page 134 – beneficiary's should be changed to member's
- 121.71(5) – Beginning on Line 4410 – Page 161 – should be clarified to more accurately state the intent of requiring additional employer contributions to address unfunded actuarial liabilities. We recommend clarifying the language to state the required employer contribution amounts in (5) are in addition to the required contributions stated in (4).

#### **IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES**

##### Government Operations Subcommittee

On March 17, 2011, the Government Operations Subcommittee adopted 10 amendments and reported the bill favorably with committee substitute.

The committee substitute revises the normal retirement date for any member initially enrolled in the FRS on or after July 1, 2011. Effective July 1, 2011, the bill increases the retirement age and years of service for new members of the Special Risk Class and the Special Risk Administrative Support Class as follows:

- Increases the age from 55 to 60 years of age; and
- Increases the years of creditable service from 25 to 30 years.

It also increases the retirement age and years of service for new members in all other classes as follows:

- Increases the age from 62 to 65 years of age; and
- Increases the years of creditable service from 30 to 33 years.

A member only needs to obtain one of the requirements, either the retirement age or the years of creditable service. These provisions do not apply to members who are enrolled in the FRS prior to July 1, 2011.

As originally filed, the bill eliminated prospectively the cost of living adjustment beginning July 1, 2011. The committee substitute maintains the cost of living adjustment.

The bill, as originally filed, reduced the disability rate for justices and judges to one third of his or her monthly compensation. The committee substitute removes the reduction and maintains the current disability benefit for justices and judges.

The committee substitute also makes conforming, clarifying, and technical changes.

##### State Affairs Committee

On March 24, 2011, the State Affairs Committee adopted a strike-all amendment and reported the bill favorably with committee substitute.

The strike-all amendment maintains the employee contribution rate; however, it reduces the rate from 5 percent of the employee's gross compensation to 3 percent. This rate applies to all membership classes.

The committee substitute eliminated prospectively the retiree health insurance subsidy beginning July 1, 2011. The strike-all amendment maintains the retiree health insurance subsidy.

The committee substitute reduced the service accrual rate for all membership classes to 1.6 percent, with the exception of members of the Special Risk Class who maintained a 3.0 percent service accrual rate. The strike-all amendment eliminates the reduction and maintains the current service accrual rates.

Finally, the strike-all amendment provides employer contribution rates to address the unfunded actuarial liabilities of the system.