

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 Committee on Appropriations

BILL: CS/SB 1114

INTRODUCER: Governmental Oversight and Accountability Committee; and Community Affairs Committee

SUBJECT: Retirement

DATE: April 21, 2014

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
	<u>White</u>	<u>Yeatman</u>		CA SPB 7046 as introduced
1.	<u>McVaney</u>	<u>McVaney</u>	<u>GO</u>	Fav/CS
2.	<u>McSwain</u>	<u>Kynoch</u>	<u>AP</u>	Pre-meeting

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 1114 makes the following changes to the Florida Retirement System (FRS), **for members initially enrolled in the FRS on or after July 1, 2015:**

- Mandates that Elected Officers' Class and Senior Management Service Class members may only join the Investment Plan;
- Changes the default for members who do not affirmatively choose a plan from the Pension Plan to the Investment Plan;
- Closes the Senior Management Service Optional Annuity Program to new members; and
- Changes the vesting period in the Pension Plan from 8 to 10 years; and
- Changes the out of service disability retirement vesting period from eight to 10 years.

Effective July 1, 2015, the bill also lowers the employee's contribution rate from three percent to two percent for all members of the Investment Plan. However, the overall amount transferred into the Investment Plan member's account remains the same – with an increase in the employer contribution being substituted for the decrease in employee contribution.

The bill creates a limited exception to the prohibition on renewed membership in the Florida Retirement System. A retiree of the Investment Plan, the Senior Management Service Optional Annuity Program (SMSOAP), the State University System Optional Retirement Program (SUSORP) or the State Community College System Optional Retirement Program (SCCSOAP) who retired before July 1, 2010, has earned less than 10 years of creditable service, and is

employed in a regularly established position with a covered employer on or after January 1, 2015, will be a renewed member in the FRS as follows:

- Investment Plan (all classes) → Investment Plan (Regular Class)
- SMSOAP → Investment Plan (Regular Class)
- SUSORP → SUSORP
- SCCSORP → SCCSORP
- Pension Plan (all classes) → Ineligible

Renewed members will have to meet the vesting requirements of the plans in which they become renewed members. Creditable service does not accrue for a retiree's employment in a regularly established position with a covered employer from July 1, 2010, through December 31, 2014, nor may employer or employee contributions be paid into a renewed member's Investment Plan account for employment with a covered employer during this time period.

The overall actuarial impact of this legislation on the Florida Retirement System is expected to be insignificant in Fiscal Year 2014-2015 and \$48.8 million in Fiscal Year 2015-2016. The actuarial impacts for later periods will be determined in the subsequent annual valuations of the FRS.

II. Present Situation:

The Florida Retirement System (FRS)

The FRS is the fourth largest public retirement system in the United States. It is a multi-employer, contributory plan, governed by the Florida Retirement System Act in ch. 121, F.S., and administered by the Department of Management Services (DMS).¹ The 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. 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.²

The FRS consists of 1,008 total employers. It is the primary retirement plan for employees of state and county government agencies, district school boards, community colleges, and universities, and also includes the 185 cities and 259 special districts that have elected to join the system.³ Members of the FRS are required to make employee contributions of three percent of their salary.⁴ As of June 30, 2012, the FRS had 621,774 active members, 347,962 retired members and beneficiaries, and 38,724 active members of the Deferred Retirement Option Program (DROP).⁵

¹ Section 121.021(5), F.S.

² The Florida Retirement System Annual Report, July 1, 2012 – June 30, 2013, at 16, available at https://www.rol.frs.state.fl.us/forms/2012-13_Annual_Report.pdf (last visited April 5, 2014).

³ *Id.*, at 17.

⁴ Prior to 1975, members of the FRS were required to make employee contributions of either 4 percent for Regular Class employees or 6 percent for Special Risk Class members. Employees were again required to contribute to the system after July 1, 2011.

⁵ Florida Retirement System 2012-2013 Annual Report, at 17.

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

- Regular Class⁶ consists of 536,506 active members, plus 6,461 in renewed membership;
- Special Risk Class⁷ includes 68,800 active members;
- Special Risk Administrative Support Class⁸ has 58 active members;
- Elected Officers’ Class⁹ has 2,094 active members, plus 152 in renewed membership; and
- Senior Management Service Class¹⁰ has 7,450 members, plus 210 in renewed membership.¹¹

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

Members of the FRS have two primary 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.

According to information provided by the SBA, approximately 45,000 new hires are processed each year for a retirement plan choice.¹² Historically, almost 26 percent have actively elected the Investment Plan, roughly 19 percent have actively elected the Pension Plan and over 55 percent have defaulted into the Pension Plan.

	Active Election to Investment Plan	Active Election to Pension Plan	Default to Pension Plan
FY 2009-10	9,071 (23.42%)	8,158 (21.06%)	21,501 (55.52%)
FY 2010-11	9,960 (24.87%)	9,042 (22.58%)	21,049 (52.56%)
FY 2011-12	10,937 (28.79%)	6,976 (18.37%)	20,064 (52.83%)
FY 2012-13	11,895 (26.23%)	7,345 (16.20%)	26,105 (57.57%)
FY 2013-14*	8,771 (25.35%)	5,709 (16.50%)	20,114 (58.14%)
TOTAL	50,634 (25.74%)	37,230 (18.93%)	108,833 (55.33%)

*Note: The counts and percentages for this fiscal year represent only those elections and defaults that occurred between July 1, 2013, and March 28, 2014.

Certain members, as specified by law and position title, may, in lieu of FRS participation, participate in optional retirement plans.

⁶ The Regular Class is for all members who are not assigned to another class. Section 121.021(12), F.S.

⁷ The Special Risk Class is for members employed as: law enforcement officers, firefighters, correctional officers, probation officers, paramedics and emergency technicians, among others. Section 121.0515, F.S.

⁸ The Special Risk Administrative Support Class is for a special risk member who moved or was reassigned to a nonspecial risk law enforcement, firefighting, correctional, or emergency medical care administrative support position with the same agency, or who is subsequently employed in such a position under the Florida Retirement System. Section 121.0515(8), F.S.

⁹ The Elected Officers’ Class is for elected state and county officers, and for those elected municipal or special district officers whose governing body has chosen Elected Officers’ Class participation for its elected officers. Section 121.052, F.S.

¹⁰ The Senior Management Service Class is for members who fill senior management level positions assigned by law to the Senior Management Service Class or authorized by law as eligible for Senior Management Service designation. Section 121.055, F.S.

¹¹ All figures from Florida Retirement System 2012-2013 Annual Report, at 47.

¹² It is uncertain how many of these new hires stay for their full career.

Investment Plan

In 2000, the Legislature created the Public Employee Optional Retirement Program (Investment Plan), a defined contribution plan offered to eligible employees as an alternative to the FRS Pension Plan.

Benefits under the Investment Plan accrue in individual member accounts funded by both employee and employer contributions and earnings. Benefits are provided through employee-directed investments offered by approved investment providers.

A member vests immediately in all employee contributions paid to the Investment Plan.¹³ With respect to the employer contributions, a member vests after completing one work year with an FRS employer.¹⁴ Vested benefits are payable upon termination or death as a lump-sum distribution, direct rollover distribution, or periodic distribution.¹⁵ The Investment Plan also provides disability coverage for both inline-of-duty and regular disability retirement benefits.¹⁶ An FRS member who qualifies for disability while enrolled in the Investment Plan must apply for benefits as if the employee was a member of the Pension Plan. If approved for retirement disability benefits, the member is transferred to the Pension Plan.¹⁷

The SBA is primarily responsible for administering the Investment Plan.¹⁸ The trustees of the SBA are the Governor as chair, the Chief Financial Officer, and the Attorney General.¹⁹ The SBA selects and contracts with a third-party administrator to provide administrative services.²⁰

The contributions paid into the individual investment accounts and into the disability account on behalf of Investment Plan members are noted below. Note that the amount paid into the retirement account as a percentage of salary includes the employee contribution of three percent.

¹³ Section 121.4501(6)(a), F.S.

¹⁴ If a member terminates employment before vesting in the Investment Plan, the nonvested money is transferred from the member's account to the SBA for deposit and investment by the SBA in its suspense account for up to five years. If the member is not reemployed as an eligible employee within five years, then any nonvested accumulations transferred from a member's account to the SBA's suspense account are forfeited. Section 121.4501(6)(b) – (d), F.S.

¹⁵ Section 121.591, F.S.

¹⁶ See s. 121.4501(16), F.S.

¹⁷ Pension Plan disability retirement benefits, which apply for Investment Plan members who qualify for disability, compensate an inline-of-duty disabled member up to 65 percent of the average monthly compensation as of the disability retirement date for special risk class members. Other members may receive up to 42 percent of the member's average monthly compensation for disability retirement benefits. If the disability occurs other than in the line of duty, the monthly benefit may not be less than 25 percent of the average monthly compensation as of the disability retirement date. Section 121.091(4)(f), F.S.

¹⁸ Section 121.4501(8), F.S.

¹⁹ Section 4, Art. IV, Fla. Const.

²⁰ The third-party administrator may not be a provider or be affiliated with a provider. Section 121.4501(8)(a), F.S.

Membership Class	Retirement Account	Disability Account	Total Rate
Regular Class	6.30%	0.25%	6.55%
Special Risk Class	14.00%	1.33%	15.33%
Special Risk Administrative Support Class	7.95%	0.45%	8.40%
Elected Officer's Class			
• Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders	9.38%	0.41%	9.79%
• Justices and Judges	13.23%	0.73%	13.95%
• County Officers	11.34%	0.41%	11.75%
Senior Management Service Class	7.67%	0.26%	7.93%

Pension Plan

The Pension Plan is administered by the secretary of the DMS through the Division of Retirement.²¹ Investment management of plan assets is handled by the SBA. As of July 1, 2013, the actuarial funding level of the plan was at 85.9 percent.²²

Any member initially enrolled in the Pension Plan before July 1, 2011, vests in the Pension Plan after completing six years of service with an FRS employer.²³ For members enrolled on or after July 1, 2011, the member vests in the Pension Plan after eight years of creditable service.²⁴ Benefits payable under the Pension Plan are calculated based on years of service multiplied by the annual accrual rate multiplied by the member's average final compensation.²⁵ For most members of the Pension Plan, normal retirement occurs at the earliest attainment of 30 years of service or age 62.²⁶ For public safety employees in the Special Risk and Special Risk Administrative Support Classes, normal retirement is the earliest of 25 years of service or age 55.²⁷ Members initially enrolled in the Pension Plan on or after July 1, 2011, have longer vesting requirements. For members initially enrolled after that date, the member must complete 33 years of service or attain age 65, and members in the Special Risk classes must complete 30 years of service or attain age 60.²⁸

Benefits payable to a Pension Plan retiree are calculated using formulas that include the average final compensation. "Average final compensation" means the average of the five or eight highest fiscal years of compensation for creditable service prior to retirement, termination, or death. If a member enrolled in the FRS prior to July 1, 2011, his or her average final compensation will be determined based on five years. If a member enrolled in the FRS on or after July 1, 2011, his or her average final compensation will be determined based on eight years. The average final compensation includes accumulated annual leave payments, not to exceed 500 hours, and all

²¹ Section 121.025, F.S.

²² Florida Retirement System Actuarial Valuation as of July 1, 2013, at I-6. .

²³ Section 121.021(45)(a), F.S.

²⁴ Section 121.021(45)(b), F.S.

²⁵ Section 121.091, F.S.

²⁶ Section 121.021(29)(a)1., F.S.

²⁷ Section 121.021(29)(b)1., F.S.

²⁸ Sections 121.021(29)(a)2. and (b)2., F.S.

payments defined as compensation in s. 121.021(22). The average final compensation does not include compensation paid to professional persons for special or particular services; payments for accumulated sick leave made due to retirement or termination; payments for accumulated annual leave in excess of 500 hours; bonuses as defined in s. 121.021(47); third party payments made on or after July 1, 1990; or fringe benefits such as automobile or housing allowances.²⁹

“Compensation” means the monthly salary paid to a member by his or her employer for work performed arising from that employment. Compensation includes overtime payments paid from a salary fund; accumulated annual leave payments; payments in addition to the employee’s base rate of pay if specified conditions apply; amounts withheld for tax sheltered annuities or deferred compensation programs, or any other type of salary reduction plan authorized under the Internal Revenue Code.³⁰

Reemployment Restrictions

For the purposes of the Pension Plan, a “retiree” means a former member of the FRS or an existing system who has terminated employment and is receiving benefit payments from the system in which he or she was a member.³¹ For the purposes of the Investment Plan, a “retiree” means a former member of the Investment Plan who has terminated employment and taken a distribution of vested employee or employer contributions, except for a mandatory distribution of a de minimis account authorized by the state board or a minimum required distribution provided the Internal Revenue Code.³²

After retiring under the FRS, a retiree can work for any private employer, for any public employer not participating in the FRS, or for any employer in another state, without affecting their FRS benefits.

However, there are certain termination requirements and reemployment limitations that affect retirement benefits **if a retiree is employed with an FRS-participating employer** during the first 12 calendar months after the effective retirement date without DROP participation or after the DROP termination date. If a retiree returns to work during the **first six calendar months** of retirement or after their DROP termination date, then their retirement application is voided and all retirement benefits, including any funds accumulated during DROP participation, must be repaid to the FRS Trust Fund. This restriction applies even if the particular position held is not covered by the FRS. A retiree cannot become a newly hired employee until after meeting the definition of termination by remaining unemployed for six calendar months.

A retiree may not receive both a salary from an FRS employer and a retirement benefit in the same month during the **seventh through twelfth calendar months** of retirement or after the DROP termination date. There are no exceptions to this reemployment limitation during this period. This restriction applies even if the particular position held is not covered by the FRS. A retiree must inform the division if they work for an FRS employer during the reemployment limitation period.

²⁹ Section 121.021(24), F.S.

³⁰ Section 121.021(22), F.S.

³¹ Section 121.021(60), F.S.

³² Section 121.4501(2)(k), F.S.

Suspended retirement benefits for the months a reemployed retiree is employed by an FRS employer during the reemployment limitation period will never be received by the retiree. The reemployed retiree and their employing agency are jointly and severally liable for repaying any retirement benefits the employee receives while working during this period.

There are no limits on working for an FRS employer after a retiree has been retired for 12 calendar months.

If a retiree is re-employed with an FRS participating employer, they will be required to sign a statement that their reemployment does not violate these provisions.³³

Before July 1, 2010, there were various exceptions to employment with FRS-covered employers during the reemployment limitation period. All reemployment limitation exceptions that were not specific to educational institutions were closed by operation of HB 479, which also extended from one month to 12 months the exclusionary period immediately after retirement in which a retiree may not be reemployed with any FRS employer.³⁴

Renewed Membership

Retirees of the FRS Pension Plan or the FRS Investment Plan who were initially re-employed in covered employment by June 30, 2010, renewed their membership in the FRS (Pension Plan or Investment Plan) or other state-administered retirement system and earn service credit toward a subsequent retirement benefit. Renewed members who retire again, including former DROP participants, are once more subject to reemployment limitations.

Renewed members are not eligible to participate in DROP or the Special Risk Class, and are not eligible for disability retirement. However, the surviving spouse and dependent children of a renewed member may qualify for survivor benefits.

Prior to July 1, 2010, retirees of a state-administered retirement system reemployed by an FRS-participating employer were eligible for renewed membership in the FRS. Currently, retirees initially re-employed in a regularly established position on or after July 1, 2010, are not eligible for renewed membership and will not earn creditable service toward a subsequent retirement benefit. This restriction from renewed membership includes retirees of the FRS Pension Plan, the FRS Investment Plan, the State University System Optional Retirement Program (SUSORP), the Senior Management Service Optional Annuity Program (SMSOAP), and the State Community College Optional Retirement Program (SCCSORP).³⁵

Reemployed Retirees without Renewed Membership

Information provided by the DMS indicates that as of December of 2013, there were 5,703 employees who retired by June 30, 2010, and subsequently returned to FRS-covered

³³ The information in this section of the bill analysis comes from the FRS Pension Plan member Handbook, 2013 edition, p. 56, located at: https://www.rol.frs.state.fl.us/forms/member_handbook.pdf. See also ss. 121.091(9), 121.122, and 1012.01(2), F.S.

³⁴ Chapter 2009-209, L.O.F.

³⁵ *Id.*, at 57. See also ss. 121.053, 121.091(9), 121.122, and 238.181, F.S.

employment, but are not permitted to be renewed members of the FRS. Of that number, 2,918 were retirees of the Pension Plan, and 2,616 were retirees of the Investment Plan. Anecdotal evidence suggests that some of these “retirees” were employees who took distributions from Investment Plan accounts prior to July 1, 2010, and rolled them into IRAs upon their termination from FRS-covered employment. The enactment on the bar to renewed membership means that anyone who took such a distribution is deemed retired, and cannot become a renewed member of the FRS.

Blended Employer Contribution Rates for the FRS for FY 2013-14

FRS employers are responsible for contributing a percentage of the member’s monthly compensation based on membership class to the Division of Retirement to be distributed into the FRS Contributions Clearing Trust Fund. 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.³⁶ In order to address unfunded actuarial liabilities (UAL) of the system, an employer contribution rate is set in statute. The rates are determined annually based on an actuarial study obtained by the DMS that calculates the necessary level of funding to support all of the benefit obligations under both FRS retirement plans.

Current Blended Employer Contribution Rates for Each Class:³⁷

Membership Class	Normal Cost Rate	UAL Rate	Total Rate
Regular Class	3.53%	2.19%	5.72%
Special Risk Class	11.00%	6.83%	17.83%
Special Risk Administrative Support Class	4.17%	30.56%	34.73%
Elected Officer’s Class			
• Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders	6.52%	24.85%	31.37%
• Justices and Judges	10.05%	17.00%	27.05%
• County Officers	8.44%	23.36%	31.80%
Senior Management Service Class	4.81%	12.27%	17.08%
Deferred Retirement Option Program (DROP)	4.63%	7.01%	11.64%

For all membership classes, except DROP, employees contribute three percent of their compensation towards retirement.³⁸

After employer and employee contributions are placed into the FRS Contributions Clearing Trust Fund, the allocations under the Investment Plan are transferred to third-party administrators to be placed in the employee’s individual investment accounts, whereas contributions under the Pension Plan are transferred into the FRS Trust Fund.³⁹

³⁶ Section 121.70(1), F.S.

³⁷ Section 121.71(4)-(5), F.S.

³⁸ Section 121.71(3), F.S.

³⁹ See sections 121.4503 and 121.72(1), F.S.

2013 FRS Valuation

Annually, the Department of Management Services contracts with the state actuary to complete an actuarial valuation of the FRS Pension Plan. The table below summarizes the market assets, actuarial assets, actuarial liabilities, the unfunded actuarial liabilities, and the funded status of the Pension Plan.⁴⁰ While the market value of the plan assets have fluctuated significantly upward and downward during the period shown, the actuarial assets have gradually grown, mostly due to the smoothing methodologies applied for the Pension Plan.

Summary of Valuation Results

	Valuation ending June 30, 2011	Valuation ending June 30, 2012	Valuation ending June 30, 2013
Market Assets	\$129.1 B	\$122.9 B	\$133.0 B
Actuarial Assets	\$126.1 B	\$127.9 B	\$131.7 B
Actuarial Liabilities	\$144.1 B	\$147.2 B	\$153.3 B
Unfunded Actuarial Liabilities	(\$18.0 B)	(\$19.3 B)	(\$21.6 B)
Funded Status	87.9%	86.9%	85.9%

State University System Optional Retirement Program

On July 1, 1984, the State University Optional Retirement Program (SUSORP) was established as an optional program under the FRS for eligible State University faculty and administrators. The program was later expanded in 1988 to include the State University System Executive Service and in 1999 to include all administrative and professional personnel exempt from career service. As of June 30, 2013, there were 17,780 participants in the SUSORP.

Eligible employees are compulsory participants in SUSORP during their first 90 days of employment. If an eligible member fails to enroll in SUSORP and execute an investment contract with a provider company during this period, the member is deemed to have elected to participate in the FRS. During the next 90 days, the member may choose to participate in the Investment Plan of the FRS. If the member fails to make an election within the first six months of employment, the member is defaulted into the Pension Plan of the FRS.

The SUSORP is a defined contribution plan qualified under the provisions of section 403(b) of the Internal Revenue Code that provides retirement and death benefits through contracts with designated investment providers⁴¹. The program was established to aid the university system in recruiting employees by offering more portability to employees who don't expect to remain in the State University System long enough to vest in the FRS Pension Plan (ten-year vesting when the SUSORP was created). It provides for full and immediate vesting of all contributions submitted to the participating companies on behalf of the participant upon signing an investment contract within 90 days of employment in an eligible position. Contributions, which are invested as directed by the participant, accumulate in individual participant accounts, together with investment earnings. At retirement, the accumulated benefits are payable to the participant or to his or her beneficiaries or estate.

⁴⁰ Florida Retirement System Actuarial Valuation as of July 1, 2011, at I-3; Florida Retirement System Actuarial Valuation as of July 1, 2012, at I-3; and Florida Retirement System Actuarial Valuation as of July 1, 2013, at I-6.

⁴¹ The five approved participating companies currently available under SUSORP are: ING, TIAA-CREF, Variable Annuity Life Insurance Company, Jefferson National Life Insurance Company, and MetLife Investors USA Insurance Company.

The employer and employee contribute the percentage of the member's salary designated by law on the member's behalf. The member selects from among the investment products offered by the provider companies in which the employer contribution is invested; a total of 0.01 percent of the salary is retained in the SUSORP Trust Fund for administrative expenses. Effective July 1, 2012, the employer contribution rate is 5.14 percent. Also effective July 1, 2011, there is a mandatory employee contribution of three percent. The member may voluntarily contribute, by salary reduction, an amount not to exceed the percentage contributed by the employer to the member's account. The FRS has an unfunded actuarial liability so the employer also pays a 2.19 percent unfunded actuarial liability contribution to the FRS Trust Fund beginning July 1, 2013. The unfunded actuarial contribution rate is set in section 121.71(5), F.S.

State Community College System Optional Retirement Program

In 1995, the Florida Legislature enacted provisions⁴² allowing faculty and certain administrators with a state community college *in the FRS Regular Class* to opt out of the FRS and enroll in an optional retirement program known as the State Community College System Optional Retirement Program (SCCORP). The board of trustees of the employing agency as authorized under section 1001.64, Florida Statutes, must implement this program either individually or in consortia with other community colleges. Effective July 1, 2012, the employer contribution rate is 5.15 percent. Also effective July 1, 2011, there is a mandatory employee contribution of three percent. The member is immediately vested upon signing an investment agreement with a provider company and may voluntarily contribute, by salary reduction, an amount not to exceed the percentage contributed by the employer to the member's account. The FRS has an unfunded actuarial liability so the employer also pays a 2.19 percent unfunded actuarial liability contribution to the FRS Trust Fund beginning July 1, 2013. The unfunded actuarial contribution rate is set in section 121.71(5), F.S.

In 2003, legislation⁴³ was enacted to give SCCORP participants an open-ended opportunity to transfer back to the FRS. If the employee elects to transfer to the Investment Plan, the employee's SCCORP account is retained and he/she starts anew under the Investment Plan. To transfer to the Pension Plan, the employee pays a specified amount⁴⁴ to receive service credit equal to his/her years of service under the SCCORP. No similar transfer opportunity is available for management-level (non-Regular Class) community college employees.

Senior Management Service Optional Annuity Program

In 1986, the Florida Legislature enacted provisions⁴⁵ creating the Senior Management Service Class under the FRS and also a non-integrated optional defined contribution plan under the FRS called the Senior Management Service Optional Annuity Program (SMSOAP). The SMSOAP allows certain state senior managers within 90-days of appointment to an eligible position to opt out of the FRS and enroll in the SMSOAP which provides immediate vesting. These certain state

⁴² See chapter 95-392, Laws of Florida.

⁴³ See section 121.051(2)(c)3., Florida Statutes, enacted by chapter 2003-260, Laws of Florida.

⁴⁴ The cost for the transfer is a sum representing the present value of the member's accumulated benefit obligation for the affected period of service.

⁴⁵ See chapter 86-149, Laws of Florida.

senior managers include members in the Senior Management Service with the State of Florida, senior-level management positions with the Florida Legislature, senior-level management positions with the State Board of Administration, senior managers in the Judicial Branch, county health department administrators and directors within the Department of Health and judges and deputy chiefs judges of compensation claims in the Division of Administrative Hearings, as well as Elected Officials who opt to participate in the Senior Management Service Class in lieu of the Elected Officers' Class of the FRS.

The SMSOAP was created to aid state government in recruiting senior managers by offering more portability of retirement benefits to those who do not expect to remain in public service long enough to vest in the FRS Pension Plan (seven-year vesting for the Senior Management Service Class at the time the class was created). As of June 30, 2013, there were 31 participants in the SMSOAP.

Under the SMSOAP, retirement and death benefits are provided through contracts with designated investment providers. The state contributes on behalf of the participant a percentage of the participant's salary as required by law. Effective July 1, 2012, the employer contribution rate is 6.27 percent. Also effective July 1, 2011, there is a mandatory employee contribution of three percent. The member may voluntarily contribute, by salary reduction, an amount not to exceed the percentage contributed by the employer to the member's account. The FRS has an unfunded actuarial liability so the employer also pays a 12.27 percent unfunded actuarial liability contribution to the FRS Trust Fund beginning July 1, 2013. The unfunded actuarial liability contribution rate is set in section 121.71(5), F.S.

The SMSOAP is also available to state elected officials who are members of the Elected Officers' Class and who choose membership in the Senior Management Service Class rather than the Elected Officers' Class. The Senior Management Service Class election must be made within six months of assuming office. Elected state officers who transfer to the Senior Management Service Class may, within 90 days of becoming a member of the class, elect membership in the SMSOAP.⁴⁶

III. Effect of Proposed Changes:

Ten Year Vesting for New Members

Section 1 amends s. 121.021, F.S., to modify the definition of "vested" or "vesting" to require that members initially enrolled in the FRS on or after July 1, 2015, vest in the Pension Plan after 10 years of creditable service rather than 8 years of creditable service.

Investment Plan Compulsory for Elected Officer's Class and Senior Management Service Class

Section 2 amends s. 121.051, F.S., to provide that employees initially enrolled on or after July 1, 2015, in positions covered by the Elected Officers' Class or the Senior Management Service Class are compulsory members of the Investment Plan, are not permitted to become members of

⁴⁶ Assistant state attorneys, assistant public defenders, assistant statewide prosecutors, assistant capital collateral regional counsels, and assistant attorneys general are not eligible to elect participation in the SMSOAP in lieu of the SMSC.

the Pension Plan, and are not eligible to use the 2nd election opportunity specified in s. 121.4501(4), F.S. Investment plan membership continues if there is subsequent employment in a position covered by another membership class. This section also makes editorial changes and corrects cross-references.

Section 9 amends provisions in s. 121.4501(4), F.S., relating to the FRS Investment Plan, to provide that employees initially enrolled on or after July, 2015, in positions covered by the Elected Officers' Class or the Senior Management Service Class are compulsory members of the Investment Plan.

The bill also amends the existing member plan choice education component, to provide that new Elected Officers' Class and Senior Management Service Class members need not be provided that education, since they will be mandatory members of the Investment Plan.

Prohibits New Elected Officers' Class Members from Joining the Senior Management Service Class or the Senior Management Service Optional Annuity Program

Section 3 amends s. 121.052, F.S., to prohibit Elected Officers' Class members from joining the Senior Management Service Class after July 1, 2015.

Section 5 amends s. 121.055, F.S., to provide that on or after July 1, 2015, elected officers eligible for membership in the Elected Officer's Class may not be enrolled in the Senior Management Service Class or in the Senior Management Service Optional Annuity Program, which is closed to all new members. Current members of the optional annuity program may retain their membership in the program.

Limited Renewed Membership

Section 4 amends s. 121.053, F.S., to allow limited renewed membership for certain elected officers who retired from the Investment Plan prior to July 1, 2010.

Section 5 also amends subparagraphs (1)(f)3. and (6)(c)6. of s. 121.055, F.S., to allow limited renewed membership for former members of the Senior Management Optional Annuity Program.

Section 7 amends s. 121.122, F.S., to provide that a retiree of the:

- Investment Plan,
- State University System Optional Retirement Program,
- Senior Management Service Optional Annuity Program, or
- State Community College System Optional Retirement Program,

who retired before July 1, 2010, has completed less than 10 years of creditable service, and is employed in a regularly established position with a covered employer on or after January 1, 2015, will be a renewed member of the Regular Class of the Investment Plan, unless employed in a position eligible for participation in the SUSORP or the SCCSORP, in which case the retiree will become a renewed member of the SUSOPRP or SCCSORP. The renewed member must satisfy the vesting requirements of the plan (one year for the Investment Plan). Members who retired and returned to renewed membership before July 1, 2010, may continue membership in the plan they choose.

Creditable service (including credit toward the retiree health insurance subsidy) does not accrue for a retiree's employment in a regularly established position with a covered employer from July 1, 2010, through December 31, 2014. Nor may employer or employee contributions be paid into a renewed member's Investment Plan account for employment with a covered employer during this time period.

Section 9 amends paragraphs (2)(e) and (4)(e) of s. 121.4501, F.S., to address participation of certain retired members of the Investment Plan, State University System Optional Retirement Program, State Community College System Optional Retirement Program, and the Senior Management Optional Annuity Program who have renewed membership as Investment Plan members.

Default to Investment Plan

Section 8 amends s. 121.35, F.S., to provide that if a member that is eligible to participate in the State University System Optional Retirement Program fails to execute a program contract after July 1, 2015, within 90 days after the date of eligibility, the member is deemed to have elected membership in the FRS Investment Plan retroactive to the date of eligibility.

Section 9 amends s. 121.4501, F.S., to provide that an employee eligible to participate in the Investment Plan is initially enrolled in the Pension Plan, and has eight months to make an irrevocable election to participate in either the Pension Plan or the Investment Plan. If the employee fails to make an election, the employee is deemed to have elected the Investment Plan.

Out of Service Disability Retirement Benefit Vesting Period Increased

Sections 6 and 10 amends ss. 121.091, F.S., and 121.591, F.S., respectively, to provide that a member of the Pension Plan initially enrolled on or after July 1, 2015, who becomes totally and permanently disabled after completing 10 years of creditable service is entitled to a monthly disability benefit.

Regardless of amount of service, a member who becomes totally and permanently disabled in the line of duty is entitled to a monthly disability benefit.

Lowered Contribution Rate for Investment Plan Members

Section 11 amends s. 121.71, F.S., to lower the required employee contribution rate for all Investment Plan members from three percent to two percent, which will require higher employer contributions, beginning July 1, 2015.

Cross References

Sections 12 through 14 amend ss. 238.072, 413.051, and s. 1012.875, F.S., respectively, to change cross references consistent with the changes in this bill.

Important State Interest

Section 15 makes a finding that the bill fulfills an important state interest.

Effective Date

The effective date of the bill is July 1, 2014.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

Because the FRS is a multi-employer Pension Plan, the effects of this bill extend to all member FRS government employers. To the extent this bill requires cities and counties to spend money or take action that requires the expenditure of money, the mandates provision of Art. VII, s. 18 of the State Constitution may apply. If those constitutional provisions do apply, in order for the law to be binding upon the cities and counties, the Legislature must find that the law fulfills an important state interest (included in section 13 of the bill), and one of the following relevant exceptions must be met:

- The expenditure is required to comply with a law that applies to all persons similarly situated; or
- The law must be approved by two-thirds of the membership of each house of the Legislature.

This bill contains a statement indicating that the bill fulfills an important state interest and the bill applies to similarly situated persons (all employers who participate in the FRS), so it appears that this exception would apply.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:**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 ch. 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.

Contractual Obligations

Article I, s. 10 of the Florida 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.⁴⁷ This “preservation of rights” provision⁴⁸ 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.⁴⁹ 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.⁵⁰

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.⁵¹ More recently, the Florida Supreme Court reaffirmed the previous holding, finding that the Legislature can alter the terms of the FRS, so long as the changes to the FRS are prospective.⁵²

This bill does not change any benefits that a member earned prior to July 1, 2015.

⁴⁷ Section 121.011(3)(d), F.S.

⁴⁸ 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).

⁴⁹ *Id.* at 1035.

⁵⁰ *Id.* at 1036.

⁵¹ *Id.* at 1037.

⁵² *Rick Scott, et al. v. George Williams, et al.*, 107 So. 3d 379 (Fla. 2013).

V. Fiscal Impact Statement:**A. Tax/Fee Issues:**

CS/SB 1114 will pass along to all employer members of the FRS an adjustment to their statutory payroll costs in order to fund the proposed benefit changes. The amount of this change will not be known until the actuarial studies are completed.

B. Private Sector Impact:

None.

C. Government Sector Impact:

A number of the provisions of the bill will result in fiscal impacts on the FRS. This legislation impacts the FRS in the following ways:

- Requires new members of the FRS to make an active election to participate in the Pension Plan of the FRS; if no active election is made, the member is enrolled in the Investment Plan of the FRS.
- Requires members of the Senior Management Class or the Elected Officers' Class initially enrolling on or after July 1, 2015, to participate in the Investment Plan of the FRS.
- Increases the service credit needed to vest in the Pension Plan of the FRS from 8 years to 10 years for all members initially enrolling in the Pension Plan on or after July 1, 2015.

Based on a special study completed April 22, 2013, the impact on the FRS is insignificant for Fiscal Year 2014-2015 and approximately \$48.8 million for Fiscal Year 2015-2016. These costs will be borne by the employers participating in the FRS.

Most of these new costs are based on shifts in contributions from members of the Investment Plan to the employers participating in the FRS. This is a result of the reduction in the employee contributions required for participation in the Investment Plan from three percent to two percent of salary. Based on total payroll reported for Fiscal Year 2012-2013, the shift from employee contributions to employer contributions would be roughly \$43.4 million annually.

VI. Technical Deficiencies:

None.

VII. Related Issues:

At present and under CS/SB 1114, employee contributions are made pre-tax thereby reducing the after-tax cost to the employee of the employee contribution. Current law and the bill permit employees to decide to participate in the Pension Plan or the Investment Plan subsequent to the employee first becoming eligible to participate in the Florida Retirement System, including a second election that all employees have as to plan selection. The Internal Revenue Service (IRS)

has approved the existing situation, most recently in a private letter ruling dated January 28, 2014.⁵³

The bill reduces employee contributions for participants in the Investment Plan effective July 1, 2015. That change, coupled with the existing ability of FRS members to change retirement plans, would require a new determination by the IRS. The IRS currently has requests pending for public plans that offer employees plan choices which include different employee contribution rates. To date, the IRS has viewed any election that results in more or less taxable compensation to an employee as a “cash or deferred arrangement” prohibited by s. 401(k)(4)(B)(II) of the Internal Revenue Code, unless (1) the plan allowed a pre-tax cash or deferred arrangement on the grandfather date of that prohibition, May 6, 1986, or (2) the election is “a one-time irrevocable election made no later than the employee’s first becoming eligible under the plan.”⁵⁴ How the IRS would rule on the plan as designed in this bill is unknown.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 121.021, 121.051, 121.052, 121.053, 121.055, 121.091, 121.122, 121.35, 121.4501, 121.591, 121.71, 238.072, 413.051, and 1012.875.

The bill creates an undesignated section of Florida law.

IX. Additional Information:

A. Committee Substitute – Statement of Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Governmental Oversight and Accountability on April 10, 2014:

The CS makes the following changes to the Florida Retirement System (FRS), for members initially enrolled in the FRS on or after July 1, 2015:

- Mandates that Elected Officers’ Class and Senior Management Service Class members may only join the Investment Plan;
- Changes the default for members who do not affirmatively choose a plan from the Pension Plan to the Investment Plan;
- Closes the Senior Management Service Optional Annuity Program to new members; and
- Changes the vesting period in the Pension Plan from 8 to 10 years;
- Changes the out of service disability retirement vesting period from 8 to 10 years.

The CS also lowers the employee’s contribution rate from three percent to two percent for all members of the Investment Plan, beginning July 1, 2015. However, the overall amount transferred into the Investment Plan member’s account remains the same – with

⁵³ Letter from Carlton A. Watkins, Department of the Treasury, Internal Revenue Service (January 28, 2014), on file with the Senate Appropriations Committee.

⁵⁴ E-mail from David Powell, Groome Law Group, Chartered, (April 14, 2014), on file with the Senate Appropriations Committee.

an increase in the employer contribution being substituted for the decrease in employee contribution.

The CS also permits limited renewed membership for certain retirees of the Investment Plan and the optional retirement programs to participate as renewed members of the Investment Plan or the optional retirement programs.

B. Amendments:

None.

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