

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1551 Florida Retirement System

SPONSOR(S): Tomkow

TIED BILLS: **IDEN./SIM. BILLS:** SB 1810

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR or BUDGET/POLICY CHIEF |
|---------------------------------------|-----------|------------|--|
| 1) Government Operations Subcommittee | 14 Y, 0 N | Villa | Toliver |
| 2) Appropriations Committee | 25 Y, 0 N | Harrington | Pridgeon |
| 3) State Affairs Committee | 23 Y, 0 N | Villa | Williamson |

SUMMARY ANALYSIS

The Florida Retirement System (FRS) is a multiple-employer, contributory plan that provides retirement income benefits for employees of state and county government agencies, district school boards, state colleges, and universities. It also serves as the retirement plan for participating employees of the cities and special districts that have elected to join the system. Members of the FRS have two plan options available for participation: the pension plan, which is a defined benefit plan, and the investment plan, which is a defined contribution plan.

A member of the FRS is required to terminate employment in order to begin receiving benefits. Termination occurs when a member ceases all employment relationships with his or her FRS employer. Termination is void if any FRS-participating employer reemploys a member during a specified period of time.

The bill authorizes a person who has retired from the FRS to provide volunteer services to an FRS employer without violating the provision of law requiring termination from employment. The bill authorizes the Division of Retirement within the Department of Management Services to adopt rules establishing criteria for volunteer services that retirees may provide to an FRS employer. The bill authorizes employers to establish volunteer programs in accordance with such rules.

The bill specifies that termination under the FRS occurs when a member ceases all employment relationships with, and ceases providing services to, any FRS employer. The bill requires that all terminations must be a termination of employment as defined in federal regulations.

The bill does not appear to have a fiscal impact on the state government or local governments.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

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 FRS, 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.¹ The FRS is a contributory system, with active members contributing three percent of their salaries.²

The FRS is a multiple-employer, contributory plan³ governed by the Florida Retirement System Act.⁴ As of June 30, 2021, the FRS had 635,266 active members, 440,307 annuitants, 15,138 disabled retirees, and 31,655 active participants of the Deferred Retirement Option Program (DROP).⁵ As of June 30, 2021, the FRS consisted of 985 total employers; it is the primary retirement plan for employees of state and county government agencies, district school boards, Florida College System institutions, and state universities, and includes 179 cities and 151 special districts that have elected to join the system.⁶

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

- The Regular Class⁷ has 541,698 active members and 7,645 in renewed membership;
- The Special Risk Class⁸ has 74,355 active members and 1,163 in renewed membership;
- The Special Risk Administrative Support Class⁹ has 98 active members and one in renewed membership;
- The Elected Officers' Class¹⁰ has 2,095 active members and 110 in renewed membership; and
- The Senior Management Service Class¹¹ has 7,875 active members and 220 in renewed membership.¹²

Plan Choice

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

- The defined contribution plan, also known as the FRS Investment Plan; and
- The defined benefit plan, also known as the FRS Pension Plan.

¹ Florida Retirement System Pension Plan and Other State Administered Retirement Systems Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2021, at p. 35 available at: https://employer.frs.fl.gov/forms/2020-21_ACFR.pdf (last visited January 25, 2022).

² Prior to 1975, members of the FRS were required to make employee contributions of either four percent for Regular Class employees or six percent for Special Risk Class members. Employees were again required to contribute to the system after July 1, 2011. Members in the Deferred Retirement Option Program do not contribute to the system.

³ Prior to 1975, members of the FRS were required to make employee contributions of either 4 percent for Regular Class members or 6 percent for Special Risk Class members. Members were again required to contribute to the system after June 30, 2011.

⁴ Chapter 121, F.S.

⁵ FRS Comprehensive Annual Report, *supra* note 1 at 164.

⁶ *Id.* at 200.

⁷ The Regular Class is for all members who are not assigned to another class. Section 121.021(12), F.S.

⁸ 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.

⁹ 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.

¹⁰ 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.

¹¹ 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.

¹² All figures are from FRS Comprehensive Annual Report, *supra* note 1 at 167.

When an employee is initially hired in an FRS-covered position, the member has eight months after the month of hire to choose to participate in either the pension plan or the investment plan. If the employee does not choose within that period, a member in the Special Risk Class is deemed to have chosen to participate in the pension plan and all other members are deemed to have chosen to participate in the investment plan. After a member has made an active election to participate in a plan or the member's choice window has expired, the member has one additional opportunity to choose to switch between plans (this is referred to as the second election).¹³

Investment Plan

In 2000, the Public Employee Optional Retirement Program (investment plan) was created as 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.¹⁴ With respect to the employer contributions, a member vests after completing one year of creditable service with an FRS employer.¹⁵ Vested benefits are payable upon termination or death as a lump-sum distribution, direct rollover distribution, or periodic distribution.¹⁶ The investment plan also provides disability coverage for both in-line-of-duty and regular disability retirement benefits.¹⁷ An FRS member who qualifies for disability while enrolled in the investment plan may apply for benefits as if the employee were a member of the pension plan. If approved for retirement disability benefits, the member is transferred to the pension plan.¹⁸

The State Board of Administration (SBA) is primarily responsible for administering the investment plan.¹⁹ The Board of Trustees of the SBA is comprised of the Governor as chair, the Chief Financial Officer, and the Attorney General.²⁰

Pension Plan

The pension plan is administered by the secretary of the Department of Management Services (DMS) through the Division of Retirement.²¹ Investment management is handled by the SBA.

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.²² A member initially enrolled on or after July 1, 2011, vests in the pension plan after eight years of creditable service.²³ Benefits payable under the pension plan are calculated based on the member's years of creditable service multiplied by the service accrual rate multiplied by the member's average final compensation.²⁴ For most current members of the pension plan, normal retirement, which is when a member is first eligible for unreduced benefits, occurs

¹³ Section 121.4501(4)(b), F.S.

¹⁴ Section 121.4501(6)(a), F.S.

¹⁵ 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.

¹⁶ Section 121.591, F.S.

¹⁷ See s. 121.4501(16), F.S.

¹⁸ Pension plan disability retirement benefits, which apply for investment plan members who qualify for disability, compensate an in-line-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.

¹⁹ Section 121.4501(8), F.S.

²⁰ Article IV, s. 4(e), FLA. CONST.

²¹ Section 121.025, F.S. The mission of the Division of Retirement is to deliver a high quality, innovative, and cost-effective retirement system. The Division of Retirement also administers other state-administered retirement systems and non-FRS local government retirement systems.

²² Section 121.021(45)(a), F.S.

²³ Section 121.021(45)(b), F.S.

²⁴ Section 121.091(1), F.S.

at the earliest attainment of 30 years of service or age 62.²⁵ A public safety employee in the Special Risk and Special Risk Administrative Support Classes enters normal retirement at the earliest of 25 years of service or age 55.²⁶ A member initially enrolled in the pension plan on or after July 1, 2011, has longer service requirements. A member initially enrolled on or after July 1, 2011, must complete 33 years of service or attain age 65, and a member in the Special Risk and Special Risk Administrative Support Classes must complete 30 years of service or attain age 60.²⁷

Deferred Retirement Option Program

All membership classes in the FRS Pension Plan may participate in the Deferred Retirement Option Program (DROP), which allows a member to retire without terminating employment; a member who enters DROP may extend employment for an additional 60 months. Instructional personnel employed by the Florida School for the Deaf and the Blind, instructional personnel in grades K-12, and personnel employed by a developmental research school may participate in DROP for up to 36 calendar months beyond the 60-month period.²⁸ While in DROP, the member's retirement benefits accumulate and earn interest compounded monthly.²⁹

A member in the FRS Investment Plan may not participate in DROP; investment plan members are considered retired from the FRS when the member takes a distribution from his or her account.³⁰

Employment after Retirement

A member of the FRS is required to terminate employment to begin receiving benefits or begin participation in DROP. Termination occurs when a member ceases all employment relationships with his or her FRS employer.³¹ Termination is void if any FRS-participating employer reemploys a member during a specified period of time.³² However, an FRS 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 his or her FRS benefits.³³

Before July 1, 2010, an FRS retiree was allowed to be reemployed by an FRS employer one calendar month after retiring or after the member's DROP termination date. If the retiree was reemployed during months two through 12, the retiree was not authorized to receive his or her pension benefit until month 13. However, a retiree was authorized to be reemployed as instructional personnel on an annual contractual basis after one calendar month without having his or her retirement benefits disrupted.³⁴

A member who retires on or after July 1, 2010, may not be reemployed by an FRS employer until month seven after retiring or after the member's DROP termination date. If the retiree is reemployed during months seven through 12, the retiree may not receive his or her pension benefit until month 13.³⁵ The reemployment exception for retirees reemployed as instructional personnel no longer applies to members who retire and are reemployed on or after July 1, 2010. However, a retired law enforcement officer may be reemployed as a school resource officer by an FRS-covered employer during months seven through 12 after retirement or DROP termination and receive both a salary and pension benefits.³⁶

²⁵ Section 121.021(29)(a)1., F.S.

²⁶ Section 121.021(29)(b)1., F.S.

²⁷ Section 121.021(29)(a)2. and (29)(b)2., F.S.

²⁸ Section 121.091(13)(a) and (13)(b), F.S.

²⁹ If DROP participation began prior to July 1, 2011, the effective annual interest rate was 6.5 percent. On or after July 1, 2011, the annual interest rate for DROP is 1.3 percent. Section 121.091(13)(c), F.S.

³⁰ See s. 121.4501(2)(k), F.S. MyFRS, *DROP*, available at:

https://www.myfrs.com/FRSPro_ComparePlan_Drop.htm#:~:text=FRS%20Investment%20Plan,time%20your%20DROP%20participation%20begins. (last visited January 28, 2022).

³¹ Section 121.021(39)(a), F.S.

³² *Id.*

³³ See s. 121.091(9)(a), F.S.

³⁴ Section 121.091(9)(b), F.S.

³⁵ Section 121.091(9)(c), F.S.

³⁶ Section 121.091(9)(f), F.S.

A retiree employed in violation of the reemployment limitation and the FRS employer are jointly and severally liable for reimbursement to the retirement trust fund from which the benefits were paid. Pension benefits remain suspended until repayment has been made. Benefits suspended beyond the reemployment limitation are applied towards repaying the benefits received in violation of the reemployment limitation.³⁷

Internal Revenue Code

Contributions in the FRS, a 401(a) qualified plan, are exempt from income, social security, and Medicare taxes.³⁸ In order to maintain its tax qualification, the Internal Revenue Code (IRC) requires a 401(a) retirement plan, such as the FRS, to limit a member's ability to take a distribution prior to termination of employment.³⁹ The Internal Revenue Service, the agency responsible for administering the IRC, has not provided an objective test for determining whether a termination from employment has occurred. Rather, such determination is based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date or that the services the employee would perform after such date would permanently decrease to no more than 20 percent of the average level of bona fide services performed over the immediately preceding 36-month period.⁴⁰ Facts and circumstances considered in such determination include, but are not limited to the following:

- The individual is no longer treated as an employee for other purposes such as continuation of salary and participation in employee benefit programs.
- Similarly situated employees have been treated consistently.
- Whether the employee is permitted and realistically available to perform services for other service recipients in the same line of business.⁴¹

There should be no indication that the employee and employer intended or anticipated for the employee to return to employment when he or she terminated employment. A termination must be bona fide, meaning it is not a mere subterfuge to initiate an otherwise impermissible benefit distribution. Such action would violate s. 401(a) of the IRC and result in disqualification of the retirement plan.⁴²

A retirement plan must comply with its terms, even if those terms are stricter than the IRC. Thus, if the plan requires a termination of employment to commence a benefit, such as the FRS, then a termination of employment is required to commence a benefit distribution. Violation of such a requirement would disqualify the plan for federal tax purposes unless corrected.⁴³

Effect of the Bill

The bill authorizes a person who has retired from the FRS to provide volunteer services to an FRS employer without violating the provision of law requiring termination from employment. The bill authorizes the Division of Retirement within DMS to adopt rules establishing the criteria for volunteer

³⁷ Section 121.091(9)(b)1. and (9)(c)3., F.S.

³⁸ IRS, *Government Retirement Plans Toolkit*, available at: <https://www.irs.gov/government-entities/federal-state-local-governments/government-retirement-plans-toolkit> (last visited January 28, 2022).

³⁹ See IRC section 401(a)(36).

⁴⁰ The 20 percent level establishes a presumption of termination. In addition, a plan may treat another level of reduction in bona fide services as a separation from service, provided that the level of reduction required is designated in writing as a certain percentage that is greater than 20 but less than 50 percent of the average level of service provided in the immediately preceding 36 months. An employee is presumed not to have terminated employment where the services performed continue at a level greater than 50 percent of the average level of service during the preceding 36-month period. 26 C.F.R. s. 1.409A-1(h)(1)(ii).

⁴¹ The regulation provides the following example: an employee may demonstrate that the employer and employee reasonably anticipated that the employee would cease providing services, but that, after the original cessation of services, business circumstances such as termination of the employee's replacement caused the employee to return to employment. Although the employee's return to employment may cause the employee to be presumed to have continued in employment because the employee is providing services at a rate equal to the rate at which the employee was providing services before the termination of employment, the facts and circumstances in this case would demonstrate that at the time the employee originally ceased to provide services, the employee and the service recipient reasonably anticipated that the employee would not provide services in the future. *Id.*

⁴² Private Letter Ruling 201147038.

⁴³ See Rev. Proc. 2021-30, section 5.01(2).

services that retirees may provide to an FRS employer. The bill authorizes employers to establish volunteer programs in accordance with such rules.

The bill modifies the definition of the term “termination” and provides that termination occurs when a member ceases all employment relationships with, and ceases providing services to, all employers.⁴⁴

The bill provides that all terminations must be a termination of employment as defined in 26 C.F.R. s. 1.049A-1(h)(1)(ii). The Federal regulation provides that whether a termination of employment has occurred is based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date or that the level of bona fide services the employee would perform after such date would permanently decrease to no more than 20 percent of the average level of service performed in the preceding three-year period.

B. SECTION DIRECTORY:

Section 1 amends s. 121.021, F.S., relating to definitions.

Section 2 amends s. 121.091, F.S., relating to benefits payable under the system.

Section 3 provides an effective date of July 1, 2022.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

None.

⁴⁴ Section 121.021(10), F.S., defines the term “employer” as any agency, branch, department, institution, university, institution of higher education, or board of the state, or any county agency, branch, department, board, district school board, municipality, metropolitan planning organization, or special district of the state which participates in the system for the benefit of certain of its employees, or a charter school or charter technical career center that participates in the FRS.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. The bill does not appear to require counties or municipalities to spend funds or take action requiring the expenditures of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill authorizes the Division of Retirement within DMS to adopt rules establishing criteria for volunteer services that retirees may provide to an FRS employer while still being deemed to have terminated employment under the FRS.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE CHANGES

None.