

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: PCB GVOPS 13-01 Florida Retirement System

SPONSOR(S): Government Operations Subcommittee

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

| REFERENCE | ACTION | ANALYST | STAFF DIRECTOR or BUDGET/POLICY CHIEF |
|----------------------------------------------------|--------|------------|------------------------------------------|
| Orig. Comm.: Government Operations Subcommittee | | Harrington | Williamson |

SUMMARY ANALYSIS

The Florida Retirement System (FRS) is a multi-employer, contributory plan that provides retirement income benefits to 623,011 active members, 334,682 retired members and beneficiaries, and 40,556 members of the Deferred Retirement Option Program. It is the primary retirement plan for employees of the 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 185 cities and 257 independent hospitals and 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. In addition to the two primary plans, some eligible members have the choice of participating in optional retirement plans, which include the Senior Management Service Optional Annuity Program, State Community College System Optional Retirement Program, and the State University System Optional Retirement Program.

This bill makes changes to the FRS, including, but not limited to:

- Closing the pension plan (defined benefit) to new enrollees, and requiring all new enrollees to participate in the investment plan (defined contribution), effective January 1, 2014;
- Eliminating the option for new enrollees to apply for disability benefits, effective January 1, 2014;
- Expanding the investment options available to investment plan members;
- Closing the Senior Management Service Optional Annuity Program to new participants, effective January 1, 2014; and
- Prohibiting elected officials from joining the Senior Management Service Class in lieu of participation in the Elected Officers' Class, effective January 1, 2014.

The bill does not impact the ability of any current FRS enrollee to select participation in the pension plan or the investment plan. Changes included in the bill only pertain to new enrollees initially enrolled in the system on or after January 1, 2014.

The bill provides that a proper and legitimate state purpose is served, which includes providing benefits that are managed, administered, and funded in an actuarially sound manner.

The bill has an indeterminate fiscal impact on state and local governments. 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.¹ The FRS is a contributory system, with all members contributing 3 percent of their salaries.²

The FRS is governed by the Florida Retirement System Act.³ The FRS, which is a multi-employer, contributory plan, provides retirement income benefits to 623,011 active members,⁴ 334,682 retired members and beneficiaries, and 40,556 members of the Deferred Retirement Option Program.⁵ 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 185 cities and 257 independent hospitals and special districts that have elected to join the system.⁶

The membership of the FRS is divided into five membership classes:⁷

- Regular Class⁸ consists of 543,195 members (87 percent of the membership);
- Special Risk Class⁹ includes 70,005 members (11.2 percent);
- Special Risk Administrative Support Class¹⁰ has 59 members (.009 percent);
- Elected Officers' Class¹¹ has 2,206 members (0.35 percent); and
- Senior Management Service Class¹² has 7,546 members (1.21 percent).

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

¹ *The Florida Retirement System Annual Report*, July 1, 2010 – June 30, 2011, at 38. A copy of the report can be found online at: http://www.dms.myflorida.com/human_resource_support/retirement/publications/system_information/annual_reports.

² 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.

³ Chapter 121, F.S.

⁴ As of June 30, 2012, the FRS defined benefit plan, also known as the pension plan, had 517,756 members, and the defined contribution plan, also known as the investment plan, had 105,255 members. Email from staff of the Division of Retirement, Department of Management Services, October 16, 2012 (on file with the Government Operations Subcommittee).

⁵ *Id.*

⁶ Florida Retirement System Participating Employers for Plan Year 2012-13, prepared by the Department of Management Services, Division of Retirement, Revised September 2012, at 8. A copy of the document can be found online at: http://www.dms.myflorida.com/human_resource_support/retirement/publications/informational_booklets.

⁷ *Florida Retirement System*, Department of Management Services PowerPoint Presentation before the Government Operations Subcommittee, January 16, 2013 (on file with the Government Operations Subcommittee).

⁸ The Regular Class is for all members who are not assigned to another class. Section 121.021(12), F.S.

⁹ 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.

¹⁰ 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.

¹¹ 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.

¹² 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.

- The defined contribution plan, also known as the investment plan.

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

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. 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 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 in-line-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 were a member of the pension plan. If approved for retirement disability benefits, the member is transferred to the pension plan.¹⁷

The State Board of Administration (SBA) is primarily responsible for administering the investment plan.¹⁸ The SBA is comprised of the Governor as chair, the Chief Financial Officer, and the Attorney General.¹⁹

Pension Plan

The pension plan is administered by the secretary of the Department of Management Services through the Division of Retirement.²⁰ Investment management is handled by the State Board of Administration.

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.²¹ For members enrolled on or after July 1, 2011, the member vests in the pension plan after eight years of creditable service.²² Benefits payable under the pension plan are calculated based on years of service x accrual rate x average final compensation.²³ For most members of the pension plan, normal retirement occurs at the earliest attainment of 30 years of service or age 62.²⁴ 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

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 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.

¹⁸ Section 121.4501(8), F.S.

¹⁹ Section 4, Art. IV, Fla. Const.

²⁰ Section 121.025, F.S.

²¹ Section 121.021(45)(a), F.S.

²² Section 121.021(45)(b), F.S.

²³ Section 121.091, F.S.

²⁴ Section 121.021(29)(a)1., F.S.

age 55.²⁵ 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 60.²⁶

Optional Retirement Programs

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

- Members of the Senior Management Service Class may elect to enroll in the Senior Management Service Optional Annuity Program;²⁷
- Members in specified positions in the State University System may elect to enroll in the State University System Optional Retirement Program,²⁸ and
- Members of a Florida college may elect to enroll in the State Community College System Optional Retirement Program.²⁹

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. 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.³⁰ 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.

The following are the current employer contribution rates for each class:³¹

| Membership Class | Effective July 1, 2012 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|
| Regular Class | 3.55% |
| Special Risk Class | 11.01% |
| Special Risk Administrative Support Class | 3.94% |
| Elected Officer’s Support Class <ul style="list-style-type: none"> • Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, Public Defenders • Justices and Judges • County Officers | 6.51% 10.02% 8.36% |
| Senior Management Service Class | 4.84% |

Regardless of employee class, all employees contribute 3 percent of their compensation towards retirement.³²

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

²⁵ Section 121.021(29)(b)1., F.S.

²⁶ Sections 121.021(29)(a)2. and (b)2., F.S.

²⁷ The Senior Management Service Optional Annuity Program (SMSOAP) was established in 1986 for members of the Senior Management Service Class. Employees in eligible positions may irrevocably elect to participate in the SMSOAP rather than the FRS. Section 121.055(6), F.S.

²⁸ Eligible participants of the State University System Optional Retirement Program (SUSORP) are automatically enrolled in the SUSORP. However, the member must execute a contract with a SUSORP provider within the first 90 days of employment or the employee will default into the pension plan. If the employee decides to remain in the SUSORP, the decision is irrevocable and the member must remain in the SUSORP as long as the member remains in a SUSORP-eligible position. Section 121.35, F.S.

²⁹ If the member is eligible for participation in a State Community College System Optional Retirement Program, the member must elect to participate in the program within 90 days of employment. Unlike the other optional programs, an employee who elects to participate in this optional retirement program has one opportunity to transfer to the FRS. Section 1012.875, F.S.

³⁰ Section 121.70(1), F.S.

³¹ Section 121.71(4), F.S.

³² Section 121.71(3), F.S.

the employee's individual investment accounts, whereas contributions under the pension plan are transferred into the FRS Trust Fund.³³

Effect of the Bill

The bill makes changes to the FRS; however, benefits already earned are not impacted by changes in this bill. In addition, employees who are initially enrolled in the FRS before January 1, 2014, will not have their retirement choices impacted.

Effective July 1, 2013, the bill:

- Closes the pension plan (defined benefit) to new enrollees, and requires all new enrollees to participate in the investment plan (defined contribution), effective January 1, 2014;
- Eliminates the option for new enrollees to apply for disability benefits, effective January 1, 2014;
- Expands the investment options available to investment plan members;
- Closes the Senior Management Service Optional Annuity Program to new participants, effective January 1, 2014; and
- Prohibits elected officials from joining the Senior Management Service Class in lieu of participation in the Elected Officers' Class, effective January 1, 2014.

Closing the Pension Plan

The bill provides that effective January 1, 2014, new enrollees in the FRS will be compulsory members of the investment plan. Enrollees initially enrolled in the system before January 1, 2014, will continue to have a choice between the two primary plans, but members enrolled on or after January 1, 2014, will be automatically enrolled into the investment plan.

Except for members who are eligible for an optional retirement plan, or eligible to withdraw from the FRS, all other members will be compulsory members of the investment plan.

Disability Benefits

The bill provides that new members of the FRS, who initially enroll on or after January 1, 2014, will not be eligible for disability benefits.

Investment Options

The bill directs the State Board of Administration (SBA) to create investment products that will be offered to participants in the investment plan. In addition, the SBA is directed to contract for employee-directed brokerage services to be offered to increase investment plan investment options. The bill provides criteria for the SBA to consider when selecting the provider of the brokerage services, requirements for the provider, as well as minimum investment requirements for participation in the brokerage account.

Optional Retirement Programs

The bill closes the Senior Management Service Optional Annuity Program to new members on January 1, 2014. Any member eligible before January 1, 2014, may elect to participate in the annuity program before January 1, 2014, and members currently enrolled in the annuity program may continue to participate in that program. No new members may join the program on or after January 1, 2014.

The bill provides that an employee who has elected to participate in the State Community College System Optional Retirement Program may elect to withdraw from the optional retirement program and transfer to the FRS before December 31, 2013. After that date, an employee who elects to participate in the State Community College System Optional Retirement Program may not transfer out of the optional retirement program. As a result, the bill makes the employee's election to participate in this optional program irrevocable on and after January 1, 2014.

³³ See ss. 121.4503 and 121.72(1), F.S.

The bill provides that employees who are eligible for the State University System Optional Retirement Program will default to the FRS Investment Plan on and after January 1, 2014, if the member does not participate in the optional retirement program. Currently, the member defaults into the pension plan.

Elected Officials

The bill prohibits elected officials from joining the Senior Management Service Class in lieu of participating in the Elected Officers' Class. Because the Senior Management Service Optional Annuity Program will not be offered on or after January 1, 2014, elected officers will no longer be able to switch service classes for the purpose of participating in the optional annuity program. Instead, elected officials can participate in the FRS or withdraw from the system.³⁴

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 determination letter from the Federal Internal Revenue Service (IRS) upon the bill becoming a law. If the IRS refuses to act on the request for a determination letter, a legal opinion from a tax attorney can be substituted.

The bill 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. 121.051, F.S., limiting the ability of members of an optional retirement program to transfer to the FRS; providing for compulsory membership in the FRS Investment Plan for employees initially enrolled after a specified date; authorizing certain employees to participate in the investment plan.

Section 2 amends s. 121.052, F.S., prohibiting members of the Elected Officers' Class from joining the Senior Management Service Class after a specified date.

Section 3 amends s. 121.055, F.S., closing the Senior Management Service Optional Annuity Program to new members on a specified date; prohibiting an elected official eligible for membership in the Elected Officers' Class from enrolling in the Senior Management Service Class Optional Annuity Program; closing the Senior Management Service Class Optional Annuity Program to new members after a specified date.

Section 4 amends s. 121.35, F.S., providing that certain participants in the optional retirement program for the State University System have a choice between the optional retirement program and the FRS Investment Plan; providing for compulsory membership in the investment plan for certain employees.

Section 5 amends s. 121.4501, F.S., requiring certain employees initially enrolled in the FRS on or after a specified date to be compulsory members of the investment plan; providing for the transfer of certain contributions; revising a provision relating to acknowledgment of an employee's election to participate in the investment plan; requiring the SBA to develop investment products to be offered in the investment plan; requiring the SBA to provide a self-directed brokerage account as an investment option; providing self-directed brokerage account requirements; revising the education component; deleting the obligation of system employers to communicate the existence of both retirement plans; providing the state board and the provider of the self-directed brokerage account investment option with certain responsibilities; providing that the state board is not required to deliver certain information regarding the self-directed brokerage account; making conforming changes; removing unnecessary language; providing that certain investment plan members are not entitled to disability benefits.

Section 6 amends s. 121.591, F.S., limiting disability benefits to eligible members.

³⁴ Members of the Elected Officers' Class may withdraw from the FRS. Section 121.052(3), F.S.

Section 7 amends s. 121.71, F.S., revising the required employer retirement contribution rates for members of each membership class and subclass of the FRS.

Section 8 amends s. 238.072, F.S., conforming cross references.

Section 9 amends s. 413.051, F.S., conforming cross references.

Section 10 provides that the act fulfills an important state interest.

Section 11 requires the SBA and the Department of Management Services to request a determination letter from the United States Internal Revenue Service; providing for severability.

Section 12 provides an effective date of July 1, 2013, unless otherwise expressly provided in the act.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See below Fiscal Comments.

2. Expenditures:

See below Fiscal Comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

See below Fiscal Comments.

2. Expenditures:

See below Fiscal Comments.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

The fiscal impact of closing the pension plan to new enrollees and eliminating the disability benefit for such enrollees is unknown. The Department of Management Services has been requested to perform an actuarial study to determine the fiscal impact on the state and other participating employers. The department indicated the study will be completed by February 15, 2013.

Closing the Senior Management Service Class Optional Annuity Program to new participants will have an insignificant fiscal impact on the FRS.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision of Art. VII, s. 18, of the State Constitution may apply because this bill requires cities and 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 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 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.³⁵ This "preservation of rights" provision³⁶ 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.³⁷ 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.³⁸

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.³⁹ 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.⁴⁰

This bill does not change any benefits that a member earned prior to January 1, 2014. In fact, members enrolled in the FRS before January 1, 2014, should experience no change in the benefits available under the FRS. The bill only changes the FRS system for new enrollees, enrolling in the system on or after January 1, 2014.

³⁵ Section 121.011(3)(d), F.S.

³⁶ 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).

³⁷ *Id.* at 1035.

³⁸ *Id.* at 1036.

³⁹ *Id.* at 1037.

⁴⁰ *Rick Scott, et al. v. George Williams, et al.*, 2013 WL 173955 (Fla. 2013).

B. RULE-MAKING AUTHORITY:

The constitutional separation of powers doctrine prevents the Legislature from delegating its constitutional duties. Because legislative power involves the exercise of policy-related discretion over the content of law, any discretion given an agency to implement a law must be “pursuant to some minimal standards and guidelines ascertainable by reference to the enactment establishing the program.”⁴¹ The bill grants rulemaking authority to the SBA to implement provisions of the bill and provides standards for such implementation.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Death and Disability Benefits

The Florida House of Representatives has requested the Department of Management Services to perform three actuarial studies to determine the fiscal impact on the state and other participating FRS employers associated with the following death or disability benefit options for investment plan participants as follows:

- Employees initially enrolled in the FRS on or after January 1, 2014, will not be eligible to elect to switch to the defined benefit plan for purposes of receiving a disability benefit. The department indicated the study will be completed by February 15, 2013.
- Employees initially enrolled in the FRS on or after January 1, 2014, will be eligible to transfer to the pension plan for purposes of receiving a disability benefit in the same manner as provided in current law. The department indicated the study will be completed by March 7, 2013.
- Providing in-line-of-duty survivor benefits for all members of the investment plan. The department indicated the study will be completed by April 4, 2013.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

⁴¹ *Askew v. Cross Key Waterways*, 372 So.2d 913, 925 (Fla. 1978).