

The FRS is a predominantly local government plan with state officers and employees comprising only about 25 percent of the total membership. The other principal employer categories are district school boards, counties, and community colleges. Membership is compulsory for state agencies and constitutional entities. Municipalities and independent special districts may participate as optional members upon resolution of their governing authorities. Withdrawal of optional membership can be affected only by statute and was last done in 1995 for public hospitals.

Benefit administration is the responsibility of a statutory agency, the Division of Retirement in the Department of Management Services (DMS). Investment activities are conducted by a constitutional agency, the State Board of Administration, headed by the Governor, Comptroller, and Treasurer in their collegial capacity as Trustees of the Florida Retirement System. Article X, s. 14, State Constitution, provides that all public pension plans in the State of Florida must fund promised benefits in advance in a sound actuarial manner.

The FRS was created in 1970 as the successor benefit plan to the separate Teachers' Retirement System, Highway Patrol Retirement Plan, and State and County Officers' and Employees Retirement System. The predecessor teachers' plan was approaching insolvency and its combination with the other solvent plans rescued it from collapse. In 1972 the FRS incorporated the last independent state retirement plan, the Judicial Retirement System. Today it covers about 600,000 active employees and nearly 200,000 retirees. Active members may choose to participate in a Deferred Retirement Option Program (DROP) during the last five years of their service. Under its provisions participants have their monthly pension benefit paid into an interest bearing account. Upon termination of employment they receive the additional options of a full or partial lump sum payment of that amount plus its accrued 6.5 percent interest or they may transfer the account balance plus accrued interest into a qualified retirement plan.

Retired members receive a 3 percent fixed cost-of-living allowance each July 1 on their monthly benefit. Members who have terminated employment with vested rights, that is, the right to receive a benefit, do not have these benefits indexed to inflation until commencement of pension payments. State of Florida employees have the option of maintaining their health insurance coverage at retirement at full cost less a monthly Health Insurance Subsidy payment equal to \$5 per month per year of service, not to exceed \$150.

Between 1984 and 1999 the Legislature created three other alternative pension arrangements to the FRS for covered employees. Administrators and faculty in the State University System and the Community College System and executives in the Senior Management Service may enroll in a defined contribution plan. About 12,000 employees among all three employer types have selected this choice. A defined contribution (DC) plan offers the participant the choice of pension portability from employer to employer, immediate or 1-year vesting instead of 6-year vesting, and personal ownership of, as well as personal responsibility for the investment choices. These plans are "front-loaded," that is, they provide immediate ownership of pension dollars without any forfeiture should the participant terminate employment prior to vesting. Employer contributions are pre-tax and are roughly equivalent to the normal costs of the DB portion of the FRS. Employees may make post-tax contributions to their DC accounts subject to federal earned income limitations. DC plans operate in marked contrast to "back-loaded" DB plans which are structured to encourage career commitment and value the last five years as the most valuable. A

DC plan assures only an employer payroll contribution, not a benefit result. The time-honored euphemisms of “thirty and out” and “high five” no longer apply: net asset value at the close of markets, Eastern Time is all there is. The Florida DC plans, unlike many of their corporate 401(k)-type counterparts, are also structured as annuities and do not offer lump-sum features. Counties and school boards have the additional statutory authority to offer early retirement annuities to their departing members to compensate them for any penalties they may incur for non-normalized benefits.

The concept of early retirement in a DC plan is not linked the same way it is in the DB version. Early retirement can occur at any time following vesting when the participant determines that the account balance is sufficient. Federal law imposes a series of distribution penalties when account redemption occurs prior to age 59.5 but these penalties can be forgiven through amortization, annuitization or other structured payment distribution options.

In 1999 the Florida Senate passed Senate Bill 356. It was designed to create a DC and DB pension choice for most members of the FRS. Participants would be able to enroll in the plan of their choice and receive an equivalent payroll contribution, then set at 9.21 percent of salary, by their employer. The choice would be unconstrained and would be accompanied by employee education and information on the elements and consequences of choice. The bill was patterned after the existing optional retirement plan choices for educators and managers and the state’s deferred compensation program. Employees would enroll with one or more of the several qualified investment and insurance providers that would offer whatever array of services, or the “bundle,” the participant believed valuable to purchase. The bill did not pass the House of Representatives but did precede the discussions undertaken during the 2000 Regular Legislative Session that resulted in passage of ch. 2000-169 (HB 2393/SB 1026), Laws of Florida.

Senate Committee Interim Report 2001-021, “Implementation of Pension Choice for Florida Public Employees” discussed in greater detail how public employee benefit programs are beginning to emulate the large-scale economic transformation from a job-based to a knowledge-based environment. The report traced the evolution of the Special Category appropriation and the increasingly greater role played by government contractors and their supplanting of direct service delivery by public employees. That shift from direct to indirect service delivery was accompanied implicitly by a shift from DB to DC pension management as contractors do not envision creating streams of unfunded employer liabilities in a competitive market where business infrequently exists for a lifetime.

Chapter 2000-169, L.O.F., created a Public Employees Optional Retirement Program and provided all employee participants of the FRS the opportunity to enroll initially in a DC plan or to transfer with a discounted account balance from the DB. Each category of public employer – state, county, school board, and optional member – would be afforded a 90-day election window in which their employees could select the optional plan. Like SB 356 the choice was unconstrained – the failure to choose would maintain DB membership - and was to be accompanied by a broadly based information and education curriculum. Unlike that previous legislation, however, the plan would permit employees to transfer back to the DB plan once after their DC enrollment. It also would be organized on a wholesale, or “unbundled” basis in which the SBA would select the fund providers and slot them into predetermined asset classes. In this arrangement provider companies would compete on the basis of cost and performance of their

individual investment offerings. They would not provide ancillary services to the participant such as estate planning, related investment products, or plan servicing as those elements became either non-existent or made the responsibility of an SBA retained third-party administrator. The disaggregation of services was a central feature of ch. 2000-169 as it contemplated overlaying the investment infrastructure of the SBA over the procured best-of-class funds to produce superior returns at minimal participant cost. The SBA believed itself to be in a commanding presence to produce this result, not only as a consequence of the stated objective of the law, but also by virtue of the procurement fitting into its own organizational deployment: it purchases on a wholesale basis as an institutional investor for the DB plan. Neither it nor the Division of Retirement engages in any ancillary activities outside the narrow scope of investment management and benefit administration thus keeping expenses low enough that the division reports itself as the national public pension plan leader in organizational efficiency as measured by cost per member.

The SBA has proceeded since the passage of ch. 2000-169, L.O.F., with the assembly of the implementing apparatus. In coordination with its own Investment Advisory Council and the separately created Public Employees Optional Retirement Plan Advisory Committee it created four distinct work groups: an Investment Services Implementation Group (for the selection of investment product providers); a Third Party Administrator Implementation Group for the qualification and selection of a centralized financial services intermediary (CitiStreet); an Education Services Provider Implementation Group for initial and transfer education (Ernst and Young/Financial Engines/Watson Wyatt); and an Asset Transition Work Group for the brokerage transactions incidental to the transfer of account balances from DB to DC. In the course of its public hearings, the SBA has published an Investment Policy Statement (IPS) in which it outlined the plan design and procurement objectives. The IPS has been promulgated additionally as a rule under the state’s Administrative Procedures Act, ch. 120, F.S.

Effective March 1, 2002 the initial information and education period began for state employees with the first choice period for DB to DC enrollment to begin June 1, 2002. In succeeding calendar quarters district school boards and local governments will begin their choice periods with the open enrollment ending in early 2003 for existing employees.

III. Effect of Proposed Changes:

Section 1. The bill amends s. 121.091, F.S., to revise the penalty for early retirement in the FRS, as follows:

Proposed FRS Early Retirement Eligibility Criteria¹

Age-Based Criterion	Service-Based Criterion	Annual Reduction Factor
58 or older	25 years or more	3% per year under age 62
55 but less than 58	25 years or more	4% per year under age 62
Less than age 55	Any number of years, vested	5% per year under age 62
Any age	Less than 25 years, vested	5% per year under age 62

¹ Department of Management Services, Division of Retirement, “Substantive Bill Analysis,” February 25, 2002.

Section 2. The act takes effect July 1, 2002.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

Article VII, s. 18, State Constitution, places limits on the Legislature's ability to enact unfounded mandates on cities and counties. Article X, s. 14, State Constitution, further codified through Part VII of ch. 112, F.S., also requires that promised public pension benefits must be pre-funded in a sound actuarial manner. In its present form the bill violates all three of these legal standards. It does not contain a statement of important state interest nor does it include the necessary payroll contribution rates required to fund the penalty reduction.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

As noted, above, the bill violates two provisions of the State Constitution and the provisions of Part VII, of ch. 112, F.S.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Individual participants desiring to receive an early benefit will have the nominal penalty reduced.

C. Government Sector Impact:

The DMS advises that the following increases to the employer-paid contributions rates will be required to fund the partial forgiveness of the early retirement penalty:

Employer Payroll Contribution Rates Increases Required to Fund Benefit

Retirement Class	Contribution Increase
Regular	.45 %
Senior Management	.70 %
Justices and Judges	.23 %
Legislators, Cabinet	.86 %
County Officers	.53 %

VI. Technical Deficiencies:

Corrective amendments are required to fund the benefit in compliance with the law.

VII. Related Issues:

Participants who take advantage of early retirement are precluded from enrollment in DROP. The eligibility for DROP is an attribute of normal retirement only.

The bill does not make the forgiveness of a portion of the early retirement penalty apply to the Special Risk or Special Risk, Administrative Support Classes.

It is well recognized that the State of Florida is coping with a supply of instructional personnel in the Kindergarten through 12 grade levels in its public schools insufficient for the achievement of its public policy goals. This proposal makes departure prior to the service of a normal term slightly more attractive to all employees in the Regular Class and proportionately aggravates addressing this problem.

VIII. Amendments:

#1 by Governmental Oversight and Productivity:

Incorporates revised employer-paid payroll contribution rates, as noted above, to fund the benefit increase. (WITH TITLE AMENDMENT)