

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

This bill does not appear to implicate any of the House Principles.

B. EFFECT OF PROPOSED CHANGES:

Present situation

The Florida Retirement System (FRS) provides retirement and disability benefits for Florida state and county employees and for employees of those cities and special districts that choose to participate in the FRS. As of June 30, 2004, state employees (including university employees) represent 21.83% of the FRS membership; counties, 23.46%; district school boards, 48.3%; and community colleges, 2.84%; and cities and special districts that have opted to join the FRS, 3.57%.

The active membership of the FRS is divided into five membership classes. Each class is separately funded based upon the costs attributable to the members of that class. The classes and their current employer contribution rates as a percent of gross compensation are:

- Regular Class, 6.20%.
- Special Risk Class, 17.34%.
- Special Risk Administrative Support Class, 8.73%.
- Elected Officers' Class, 11.30%-17.46%, depending on subclass.
- Senior Management Service Class, 8.18%.

The FRS pension plan provides a defined benefit to its retirees. An active member of the FRS plan earns retirement credit for his or her service (creditable service) when the member is paid for work in a covered position with one or more of approximately 800 public employers that participate in the FRS. Members do not earn service credit under the FRS pension plan as a temporary employee or independent contractor, or while they are participating in one of several other state retirement programs.¹ Regular Class members accrue benefits at a rate of 1.60% per year of service, meaning essentially that provided the member vests in the FRS pension plan, for each year worked, upon retirement the Regular Class member's initial annual benefit is 1.60% of his or her average final compensation multiplied times the number of years worked. However, a number of factors determine a member's benefit, such as the age at which he or she retires, whether he or she receives disability retirement, or whether he or she works beyond the normal retirement date.

In addition to the service credit earned for current work, under ss. 121.111, 121.1115, 121.1122, and 121.121, F.S., members may be able to purchase credit under the FRS Pension Plan for certain other types of service worked in non-FRS covered positions to increase their benefit.² The member must meet a variety of conditions and pay any required retirement contributions, plus interest, for the extra

¹ Such programs include the Deferred Retirement Option Program (DROP); the State University System Optional Retirement Program; the State Community College System Optional Retirement Program; the Senior Management Service Optional Annuity Program or in a local government alternative plan in lieu of participating in the Senior Management Service Class; or the Public Employee Optional Retirement Program (FRS Investment Plan).

² Types of service for which a member may purchase additional retirement credit pursuant to Florida law include prior service, if reemployed in covered employment for 1 work year; past service; military service; leave of absence without pay; in-state public employment; out-of-state public employment; periods while receiving temporary worker's compensation payments; periods of suspension without pay, if reinstated; periods while teaching in a federally operated school in Florida; and periods of disability retirement, upon recovery and return to covered employment for 1 work year.

service credit.³ The cost for additional retirement credit depends on the type of service claimed. However, members cannot now buy credit for what federal law calls “nonqualified service.”⁴

The purchase of nonqualified service is allowed under sec. 415(n) of the Internal Revenue Code. As long as the conditions of sec. 415(n) are met, changing the FRS Pension Plan to allow the purchase of credit for nonqualified service should not adversely affect the qualified status of the FRS Pension Plan. The primary conditions under sec. 415(n) require a member to complete 5 years of service before becoming eligible to purchase non-qualified service, and limit to a maximum of 5 years the total amount of nonqualified service credit that may be purchased.

Proposed changes

HB 73 would allow active members of the FRS Pension Plan to buy Regular Class credit under the plan for up to 5 years of “nonqualified service for time not otherwise creditable under any other provisions of the plan.” The 5-year maximum would apply to the total of out-of-state service and in-state service purchased pursuant to ss. 121.1115 and 121.1122, F.S., and nonqualified service credit purchased pursuant to the bill. Prior to vesting, a member could purchase a year of credit for each year worked, but the associated credit would not be applicable for vesting purposes and would not be credited to the member until he or she had vested by completing 6 years of creditable service. The price would be 20% of the first salary earned under the FRS or 20% of \$12,000, whichever is higher, plus 6.5% interest compounded annually from the date of hire to the date of payment.

The additional service would enhance the individual’s final retirement benefit, increasing the percentage value by up to 8% of average final compensation (1.6% service credit per year X 5 years maximum service that may be purchased).

Based on previous relevant actuarial special studies, this price is likely to only partially cover the cost to the system. To maintain the FRS in an actuarially sound manner, employer contributions may need to be increased for all FRS employers, not just those whose employees choose to purchase credit in accordance with this section. See “*Fiscal Comments*”, below.

C. SECTION DIRECTORY:

Section 1 creates s. 121.11225, F.S., allowing the purchase of retirement credit for nonqualified service by individuals or their employers under certain conditions.

Section 2 provides an effective date of July 1, 2005.

³ In some cases, the employer may pay some or all of the cost for this credit.

⁴Sec. 401(n)(3) (C) of the Internal Revenue Code provides: “the term ‘nonqualified service’ means service for which permissive service credit is allowed other than--

(i) service (including parental, medical, sabbatical, and similar leave) as an employee of the Government of the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing (other than military service or service for credit which was obtained as a result of a repayment described in subsection (k)(3)),

(ii) service (including parental, medical, sabbatical, and similar leave) as an employee (other than as an employee described in clause (i)) of an educational organization described in section 170(b)(1)(A)(ii) which is a public, private, or sectarian school which provides elementary or secondary education (through grade 12), as determined under State law,

(iii) service as an employee of an association of employees who are described in clause (i), or

(iv) military service (other than qualified military service under section 414(u)) recognized by such governmental plan. In the case of service described in clauses [FN1] (i), (ii), or (iii), such service will be nonqualified service if recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan.”

Sec. 401(n)(3) (A) of the Internal Revenue Code states: “The term ‘permissive service credit’ means service credit-

(i) recognized by the governmental plan for purposes of calculating a participant’s benefit under the plan,

(ii) which such participant has not received under such governmental plan, and

(iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.”

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Retirement System Trust Fund may receive revenues from the purchase of credit.

2. Expenditures:

Indeterminate. No actuarial study has been performed for this bill, so the projected costs are unknown. See "Fiscal Comments", below.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

Indeterminate. No actuarial study has been performed for this bill, so the projected costs are unknown. See "Fiscal Comments", below.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

Consulting actuaries performed a study for a bill that was similar but narrower in scope in 1994. However, due to this bill's broader provisions and significant changes made to the Florida Retirement System, that study is outdated and not valid for this bill. Thus the costs of this benefit to the state and local governments that participate in the FRS are unknown.

When the law was previously changed to allow FRS members to purchase credit under the plan for their in-state and out-of-state service, the Legislature increased employer contribution rates for all membership classes to achieve actuarially sound funding because the costs paid by or on behalf of those purchasing service credit were insufficient to do so. If employer contribution rates increased as a result of this bill, these higher rates would be borne not just by state government but by counties, school districts, and those municipalities and special districts that have opted into the FRS.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Unknown. By increasing benefits for employees of FRS employers, the bill may require counties and certain municipalities to expend funds through higher employer contribution rates; in that case, it would be a mandate. However, the bill contains a statement of important state interest and does apply to all persons similarly situated. It thus meets the requirements of Art. VII, s. 18(a) to bind effectively counties and municipalities.

2. Other:

Article X, s. 14, Florida Constitution

Since 1976, the Florida Constitution has required that benefit improvements under public pension plans in the State of Florida must 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.

Part VII of Chapter 112, F.S.

Article X, s. 14 of the Florida Constitution is implemented by statute under part VII of chapter 112, F.S., the "Florida Protection of Public Employee Retirement Benefits Act," which establishes minimum standards for the operation and funding of public employee retirement systems and plans in the State of Florida. The key provision of this act states the legislative intent to "prohibit 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."

An actuarial study for a similar bill was performed in 1994; however, due to significant differences between that bill and this bill and significant changes made to the Florida Retirement System since then, that study is outdated and not valid for this bill. Thus this bill does not comply with Article X, s. 14 of the Florida Constitution and Part VII of Chapter 112, F.S.

B. RULE-MAKING AUTHORITY:

See "Drafting Issues or Other Comments", below.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The bill's provisions allowing purchase of credit after one year of service conflict with federal law allowing such purchase only after five years of service.⁵

The bill does not contain a declaration of important state interest. Such a declaration is required for the bill to bind counties and municipalities.

The bill fails to define "nonqualified service," either directly or indirectly by reference to federal law. A clear understanding of the meaning and parameters of this term is important to the proper implementation of this proposal, should it be enacted. Without clear direction, the Division of Retirement would be required to develop rules to implement the bill.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

None.

⁵ IRC sec. 415(n).