



Florida Retirement System Funds and Investment Returns Declined with the Economy; the SBA Reports That Its Investment Strategy Is Designed to Withstand Losses

at a glance

Membership in the Florida Retirement System (FRS) is open to all public employers in the state, with school districts (48%) and counties (23%) currently comprising nearly three-quarters of the membership. Members can choose between three retirement plans: the Pension Plan, the Investment Plan, and the Hybrid Plan. The FRS is managed by the Department of Management Services' Division of Retirement and the State Board of Administration.

FRS Pension Plan investment returns declined with the economy during the past fiscal year. At the end of Fiscal Year 2008-09, the Pension Plan's rate of return was a negative 19.03%, and the fund decreased by \$27 billion from the previous year. Results for the Investment Plan were similar, with a rate of return of negative 15.16% and a decrease in fund assets of \$293 million. As of June 30, 2009, the FRS Pension Plan had 88.5% of the monies needed to pay all current and future expected benefits for existing participants and their beneficiaries. However, State Board of Administration managers report that the board's investing horizon is 15 to 30 years and its investment strategy is designed to withstand short-term losses and economic downturns.

Scope

As directed by the Legislature, this is the first of a series of reports that evaluates the Florida Retirement System (FRS). This report assesses the financial condition of the system as of June 30, 2009 and answers three questions.¹

1. Are FRS Pension Plan funds sufficient to pay retiree benefits?
2. How have recent economic events affected the financial performance of the FRS Pension and Investment Plans?
3. What has been the investment performance of the Pension and Investment Plans' asset classes?

Background

The Legislature established the Florida Retirement System (FRS) in 1970. The system provides retirement, disability, and death benefits to retirees or their designated beneficiaries and offers a wide range of information services to non-retired members. The plan is funded through employer contributions and investment earnings, and serves a wide variety of government employees.

¹ The remaining three reports will examine the FRS retirement class structure; the Deferred Retirement Option Program; and defined benefit versus defined contribution plans.

Two state agencies administer the FRS. Two state entities manage the FRS: the Department of Management Services and the State Board of Administration (SBA).

The Department of Management Services' **Division of Retirement** administers the FRS Pension Plan. The Pension Plan is a defined benefit plan that provides vested members lifetime pension payments based on a percentage of their salary, years of service, and their age at retirement. The division also handles the administrative portion of the FRS, including tracking enrollment, receiving employer contributions, calculating retirement benefits, and disbursing retirement checks. In addition, it administers eight smaller retirement programs as well as the Retiree Health Insurance Subsidy Program, the Florida Retirement System Preservation of Benefits Plan, and the Deferred Retirement Option Program. The division also oversees and monitors the actuarial soundness of local government retirement systems that are not part of the FRS, as well as pension plans for municipal police and firefighters.

In Fiscal Year 2009, the Legislature appropriated \$35.0 million to the division, with \$15.8 million coming from general revenue and \$19.2 million from the FRS trust fund. The division has 194 authorized positions.

The second state entity that has FRS-related duties and responsibilities is the **State Board of Administration**.² The SBA is responsible for investing FRS monies to help ensure that investment returns are sufficient to fund current and future pensioners. It actively oversees investments made for the Pension Plan, with the plan members having no say in how the funds are invested. It also administers the FRS Investment Plan, a

² The board is composed of the Governor, the Chief Financial Officer, and the Attorney General, who serve as trustees to the retirement fund. The trustees appoint an executive director who directs a staff that oversees the financial management of the FRS and 34 other government funds.

defined contribution plan that does not provide guaranteed lifetime retirement benefits. Employees enrolled in the Investment Plan direct how their retirement funds are invested and choose from a group of 20 investment options selected by the SBA. Modeled after the private sector's 401(k) plans, retirement benefits are based on the employee's investment choices, how well the investments perform, and the strength of the financial markets when the plan member retires. Additionally, to help public employees make informed financial decisions regarding their pensions, the board coordinates with the Division of Retirement to operate the MyFRS Financial Guidance Program, which provides FRS members information and guidance through several methods, including a website and toll-free telephone number.³ The board has a budget of \$50.6 million and 182 authorized positions.⁴

FRS offers three plan options. The Florida Retirement System comprises three primary retirement plans.

- The FRS Pension Plan
- The FRS Investment Plan
- The Hybrid Plan, which is a combination of the Pension Plan and the Investment Plan. The Hybrid Plan allows employees to freeze their Pension Plan participation and direct all future employer contributions to the Investment Plan.

Employer contributions and investment income fund the FRS. The Pension, Investment, and Hybrid plans are all funded primarily from employer contributions made

³ The program includes print and video educational materials; a toll-free guidance line staffed by division counselors and private financial counselors; a website that contains plan choice information and retirement planning applications; and plan choice and retirement planning workshops.

⁴ The Legislature does not appropriate the board funds. The board is funded by management fees it charges for overseeing 35 funds and by employer contributions that are used to cover the costs of administering the Investment Plan and the costs of providing educational services to participants in both the Pension Plan and the Investment Plan.

on behalf of employees, as well as from the State Board of Administration’s investment of these contributions in various asset classes, including real estate, stocks, bonds, and alternative investments like venture capital and private equity.⁵

While the SBA determines the investment options offered by the Investment Plan, state law specifies how the board can invest Pension Plan assets. Specifically, for Pension Plan funds, Florida statutes permit the board to invest up to

- 25% of any fund in bonds, foreign currency, notes, and notes secured by first mortgages, mortgage securities, group annuity contracts, real property, and U.S. government obligations;
- 80% of any common stock, preferred stock, and interest-bearing obligations of a corporation having an option to convert into common stock;
- 10% of the entire portfolio in alternative investments defined as investment in private equity, venture, hedge, or distress funds; and
- 1.5% of the entire portfolio in economically targeted investments designed to provide superior returns to the portfolio while also economically benefitting the state.⁶

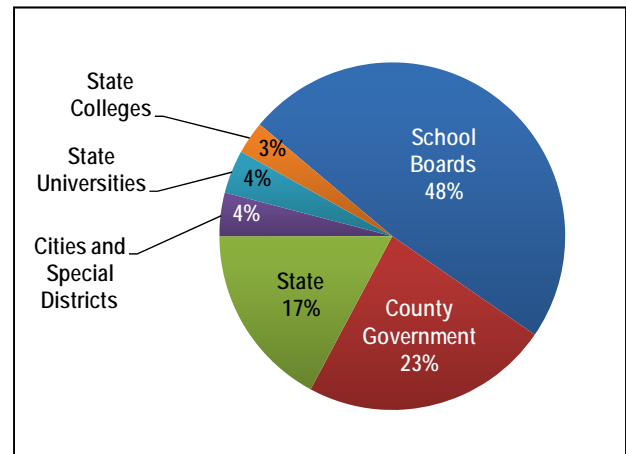
As of June 30, 2009, the net asset value for the Pension Plan was \$99.6 billion while the net asset value for the Investment Plan was \$4.1 billion.

Most FRS members are employed by local government entities. Membership in the Florida Retirement System is compulsory for all full- and part-time employees working in a regularly established position for a state agency, county government, district school

board, state university, state college, or participating city or special district.⁷ Elected officials and certain local government managers may elect not to participate in the system. Individuals who work for a government agency in a temporary or independent contractor position are not eligible for FRS membership.

As of June 30, 2009, 572,887 participants and 288,216 retiree annuitants were in the Pension Plan (see Exhibit 1). As of this date, 95,529 active employees and 21,139 retirees were in the Investment Plan, and 463 were in the Hybrid Plan. As shown in the exhibit, school district employees composed nearly half of the FRS’s active members followed by counties, and the state of Florida. State colleges, cities, and special districts employees each composed less than 5% of the FRS’s active membership.

Exhibit 1
School Districts Comprise the Largest Portion of FRS Members



Source: Division of Retirement.

⁵ Private equity is stock from companies that are not publicly traded on a stock exchange.

⁶ A 2008 OPPAGA report reviewed the SBA’s efforts to implement a targeted investment program. See *Economically Targeted Investment Program Under Development*, [OPPAGA Report No. 08-72](#), December 2008.

⁷ The Florida College System (formerly the Community College System) comprises public postsecondary educational institutions that grant two- and four-year academic degrees.

Questions and Answers –

Are FRS Pension Plan funds sufficient to pay retiree benefits?

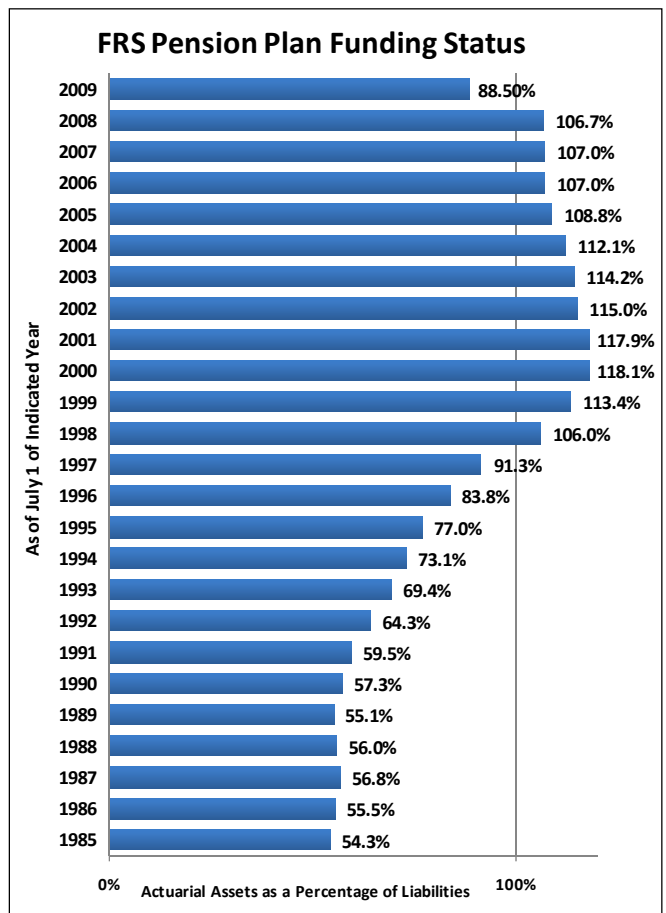
For the first time in 11 years, the FRS Pension Plan’s trust fund will not have a surplus, as its liabilities (i.e., obligated benefits payments) exceeded the value of its assets as of July 1, 2009 (see Exhibit 2). The Division of Retirement’s contracted actuary reported that as of that date, the fund had 88.5% of the monies needed to pay all current and future expected benefits for existing participants and their beneficiaries. In addition, the fund was reported to have an actuarial deficit of \$15.4 billion. In contrast, it had an actuarial surplus of \$8.2 billion at the end of the prior year.⁸ The actuary attributed these results to declining asset values caused by the economic recession as well as participants working longer and retirees living longer than expected. State legislatures typically address such shortfalls by increasing employer contributions, transferring resources from other state programs, or issuing bonds. If Florida’s plan continues to remain underfunded, the Legislature may want to consider taking similar actions.

However, it should be noted that the Pension Plan’s funding status (the ratio of a pension plan’s assets to its liabilities) exceeded most other states’ public pension plans in recent years. In its 2009 national ranking of public pension plans, Standard & Poor’s ranked Florida third in financial strength as measured by its funding ratio.⁹ Standard & Poor’s ranked the FRS as being first and third in its 2007 and 2008 reports.

⁸ From Fiscal Years 1998-99 through 2007-08, the Pension Plan had surplus assets ranging from \$7.6 billion to \$14.5 billion. These surpluses were used in part to reduce employer contributions and increase employee benefits.

⁹ These rankings are based on 2007 data, the most current data available for all 50 states.

Exhibit 2
FRS Pension Plan Liabilities Exceeded Assets in Fiscal Year 2008-09



Source: State Board of Administration.

How have recent economic events affected the financial performance of the FRS Pension and Investment Plans?

The U.S. recession that began in December 2007 and the global economic declines that followed significantly affected investment returns for the 14,000 worldwide securities comprising the Florida Retirement System Pension and Investment Plans. As shown in Exhibit 3, the Pension Plan’s one-year rate of return for June 30, 2009 was negative 19.03%. The value of fund assets as of June 30, 2009, (\$99.6 billion) was \$27 billion lower than the value as of June 30, 2008. State Board of

Administration officials report that investment results for the last four years represent short-term results and that SBA’s investing horizon is for 15 to 30 years and its investment strategy is designed to withstand short-term losses and economic downturns.

SBA managers routinely set investment performance goals, or benchmarks, with the goal of achieving an overall fund rate of return of 5% above inflation averaged over a 15-to 30-year period. Benchmarks are based on economic conditions, actuarial projections, and market indices.¹⁰ As shown in Exhibit 3, until Fiscal Year 2008-09, the board generally met its benchmarks. Board officials report that these short-term losses will likely continue until the economy rebounds.

Similar to the FRS Pension Plan’s performance, the Investment Plan’s returns increased in Fiscal Year 2005-06 and 2006-07, but began declining in Fiscal Years 2007-08 and 2008-09. Exhibit 3 shows that by the end of Fiscal Year 2008-09, the Investment Plan’s one-year rate of return was negative 15.16%. The value of the Investment Fund’s assets as of June 30, 2009 was \$293 million lower than the value as of June 30, 2008.

¹⁰ A market index tracks and measures changes in the performance of a specific group of stocks, bonds, or other investments from a specific starting point—generally July 1 of each fiscal year for FRS investments. As an example, the SBA domestic equities portfolio’s performance is assessed against the Russell 3000 index, which contains 98% of all U.S. stocks.

**Exhibit 3
FRS Pension and Investment Plan Returns Declined with the Economy but Frequently Exceeded Benchmarks**

Pension Plan Returns	Fiscal Year			
	2005-06	2006-07	2007-08	2008-09
1-Year Return	10.56%	18.07%	-4.42%	-19.03%
Target return benchmark ²	10.03%	17.85%	-4.32%	-17.89%
Met or exceeded benchmark	Yes	Yes	No	No
3-Year Return	12.42%	12.88%	7.66%	-2.96%
Target return benchmark ²	11.87%	12.32%	7.44%	-2.55%
Met or exceeded benchmark	Yes	Yes	Yes	No
5-Year Return	6.08%	11.52%	9.91%	2.17%
Target return benchmark ²	5.84%	11.30%	9.56%	2.16%
Met or exceeded benchmark	Yes	Yes	Yes	Yes
10-Year Return	8.74%	8.46%	5.85%	2.29%
Target return benchmark ²	8.42%	7.98%	5.39%	2.01%
Met or exceeded benchmark	Yes	Yes	Yes	Yes

Investment Plan Returns	Fiscal Year			
	2005-06	2006-07	2007-08	2008-09
1-Year Return	10.18%	16.01%	-4.69%	-15.16%
Benchmark return	9.35%	16.29%	-5.99%	-15.45%
Met or exceeded benchmark?	Yes	No	Yes	Yes
3-Year Return	10.98%	11.50%	6.80%	-2.11%
Benchmark return	10.90%	11.38%	6.12%	-2.59%
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
5-Year Return	na ³	na ³	8.61%	2.31%
Benchmark return	na ³	na ³	8.32%	-1.90%
Met or exceeded benchmark?	na ³	na ³	Yes	Yes

¹ The SBA’s performance goal, called target benchmark, is based on actuarial projections and economic conditions. Over the long term (i.e., 15 to 30 years), the board strives to achieve an overall fund benchmark of 5% above inflation.

² The Legislature established the Investment Plan in Fiscal Year 2002-03, so there are no five-year returns for these two fiscal years.

Source: OPPAGA analysis of State Board of Administration data.

What has been the investment performance of the Pension and Investment Plans' asset classes?

Similar to the overall fund results, return rates for Pension Plan and Investment Plan asset classes generally were lower in Fiscal Year 2008-09 than in the three preceding years. Exhibit 4 shows that for the Pension Plan, all asset classes had lower returns than previous years, with the largest negative return for the strategic investments (negative 34.58%), followed by the foreign equities (negative 29.49%), and the domestic equities (negative 26.34%).¹¹ Returns within the asset

¹¹ Strategic investments include real estate debt city, county, and state infrastructure projects; timberland; and corporate governance activist funds designed to improve returns on undervalued companies.

classes for the Investment Plan also showed losses, with the largest decreases in the foreign equities (negative 28.50%) and domestic equities (negative 26.54%) (see Exhibit 5). Most of the market indices associated with both plans' asset classes experienced negative returns as well, reflecting the general state of the economy at end of Fiscal Year-2008-09.

Agency Response _____

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was submitted to the executive director of the State Board of Administration and the secretary of the Department of Management Services for review and response. The executive director's written response is included in Appendix A. The Secretary's written response is included in Appendix B.

Exhibit 4

Financial Performance Declined for All Pension Plan Asset Classes in Fiscal Year 2008-09

Asset Class	FRS Pension Plan Returns by Asset Class			
	FY 2005-06	FY 2006-07 ¹	FY 2007-08 ¹	FY 2008-09
Domestic Equities – Stocks exclusively from U.S. companies	9.04%	19.61%	-12.68%	-26.34%
Benchmark return	9.55%	20.07%	-12.68%	-26.56%
Met or exceeded benchmark?	No	No	Yes	Yes
Percentage of fund	50.40%	42.9%	35.50%	35.29%
Foreign Equities – Stocks exclusively from countries outside of the U.S.	26.43%	29.82%	-6.52%	-29.49%
Benchmark return	27.90%	29.62%	-7.62%	-30.20%
Met or exceeded benchmark?	No	Yes	Yes	Yes
Percentage of fund	15.20%	16.4%	18.70%	20.46%
Fixed Income – Investments that yield a regular (or fixed) return, e.g., bonds	0.02%	6.32%	5.10%	2.05%
Benchmark return	-0.50%	6.53%	7.12%	6.05%
Met or exceeded benchmark?	Yes	No	No	No
Percentage of fund	21.30%	22.9%	27.6%	26.10%
Real Estate – Office, retail, industrial, and apartment buildings as well as real estate investment trusts, which are publicly traded real estate securities	23.48%	16.11%	8.69%	-21.16%
Benchmark return	9.09%	6.41%	10.12%	-24.47%
Met or exceeded benchmark?	Yes	Yes	No	Yes
Percentage of fund	4.90%	6.0%	7.70%	7.81%
Cash and Short-term Securities – High quality securities that can be sold within less than one year without a loss of value	4.31%	5.43%	0.86%	-5.37%
Benchmark return	4.35%	5.30%	4.44%	1.72%
Met or exceeded benchmark?	No	Yes	No	No
Percentage of fund	0.80%	2.9%	0.90%	0.86%
Private Equity – Stocks in companies that are not publicly traded on a stock exchange	13.15%	12.90%	7.52%	-25.41%
Benchmark return	14.06%	24.60%	-8.19%	-22.06%
Met or exceeded benchmark?	No	No	Yes	No
Percentage of fund	3.10%	3.20%	3.40%	3.60%
High Yield – Bonds that have a high potential of return to compensate for their higher risk	NA²	NA²	0.99%	-2.44%
Benchmark return	NA ²	NA ²	0.09%	-1.77%
Met or exceeded benchmark?	NA ²	NA ²	Yes	No
Percentage of fund	NA ²	NA ²	2.20%	2.51%
Strategic Investments – Real estate debt; city, county, and state infrastructure projects; timberland; and corporate governance activist funds designed to improve returns on undervalued companies	NA³	NA³	-8.86%	-34.58%
Benchmark Return	NA ³	NA ³	-8.51%	-22.00%
Met or exceeded benchmark?	NA ³	NA ³	No	No
Percentage of fund	NA ³	NA ³	4.10%	3.37%

¹ The SBA's 2006-07 and 2007-08 Investment Report lists returns that are both higher and lower than reported here, stating in footnotes that certain trades were included while others excluded from their calculations. The numbers presented here reflect all trades executed by the SBA.

² These funds were not in existence during this period.

³ This is a new asset class that received initial funding in June 2007.

Source: OPPAGA analysis of State Board of Administration data.

**Exhibit 5
Financial Performance Declined for Most Investment Plan Asset Classes In Fiscal Year 2008-09**

Asset Class	FRS Investment Plan Returns by Asset Class			
	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09
Domestic Equities – Stocks exclusively from U.S. companies	12.06%	18.84%	-11.91%	-26.54%
Benchmark Return	10.83%	19.57	-13.24%	-26.70%
Met or exceeded benchmark?	Yes	No	Yes	Yes
Percentage of Fund	35.50%	31.90%	26.10%	22.28%
Foreign/Global Equities – Stocks from both the U.S. and foreign countries	25.2%	26.67%	-6.46%	-28.50%
Benchmark Return	23.78%	26.16%	-9.59%	-30.97%
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
Percentage of Fund	8.80%	12.10%	11.20%	7.71%
Fixed Income – Investments that yield a regular (or fixed) return, e.g., bonds	-0.31%	6.41%	6.98%	5.18%
Benchmark Return	-0.32%	6.61%	6.21%	4.76%
Met or exceeded benchmark?	Yes	No	Yes	Yes
Percentage of Fund	9.10%	8.10%	9.00%	10.19%
Treasury Inflation-Protected Securities – Inflation-indexed bonds issued by the U.S. Treasury whose interest rate is linked to inflation	-1.63%	3.94%	15.30%	-0.93%
Benchmark Return	-1.64%	3.99%	15.09%	-1.12%
Met or exceeded benchmark?	Yes	No	Yes	Yes
Percentage of Fund	3.00%	2.10%	4.00%	4.10%
Cash Equivalents – Cash and high quality securities that that can be sold in less than one year with little loss of value	4.42%	5.49%	4.13%	1.11%
Benchmark Return	4.34%	5.48%	4.45%	1.72%
Met or exceeded benchmark?	Yes	Yes	No	No
Percentage of Fund	9.60%	8.80%	11.80%	18.60%
Balanced Fund – Stocks, bonds, and money market funds	10.35%	16.68%	-4.68%	15.15%
Benchmark Return	9.81%	16.84%	-4.98%	-15.97%
Met or exceeded benchmark?	Yes	No	Yes	Yes
Percentage of Fund	34.10%	37.00%	37.90%	37.12%

Source: OPPAGA analysis of State Board of Administration data.

Appendix A



STATE BOARD OF ADMINISTRATION OF FLORIDA

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CHARLIE CRIST
GOVERNOR
AS CHAIRMAN
ALEX SINK
CHIEF FINANCIAL OFFICER
AS TREASURER
BILL McCOLLUM
ATTORNEY GENERAL
AS SECRETARY
ASH WILLIAMS
EXECUTIVE DIRECTOR & CIO

January 27, 2010

Mr. Gary R. VanLandingham
Director
OPPAGA
Claude Pepper Building, Room 312
111 West Madison Street
Tallahassee, FL 32399

Dear Mr. VanLandingham:

We reviewed OPPAGA's preliminary and tentative report entitled, *Florida Retirement System Funds and Investment Returns Declined with the Economy; SBA Reports That Investment Strategy Is Designed to Withstand Losses*. We have no objection or questions in regard to the information presented in the report.

We welcome OPPAGA's efforts and, as always, we appreciate your diligence and professionalism.

Sincerely,

A handwritten signature in blue ink that reads "Ashbel C. Williams".

Ashbel C. Williams
Executive Director & CIO

cc: Ms. Florida Rivera-Alsing, Chief of Internal Audit, State Board of Administration
Ms. Sarabeth Snuggs, Director, Florida Division of Retirement
Mr. Steve Rumph, Inspector General, Department of Management Services
Ms. Kim Mills, Director of Auditing, Chief Inspector General's Office

Appendix B



Office of the Secretary
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Governor Charlie Crist

Secretary Linda H. South

February 2, 2010

Mr. Gary R. VanLandingham, Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison St., Room 312
Tallahassee, FL 32399-1450

Dear Mr. VanLandingham:

We have reviewed your preliminary and tentative reports, ***Several Options are Available for Modifying the Florida Retirement System's Class Structure to Reduce System Costs*** and ***Florida Retirement System Funds and Investment Returns Declined with the Economy; SBA Reports that Investment Strategy Designed to Withstand Losses.***

The department will implement or assist other entities in implementing any options the Legislature should choose to designate.

We appreciate your staff's efforts and cordial working relationship over the past few months. If you need additional information, please contact Steve Rumph, Inspector General, at 488-5285.

Sincerely,

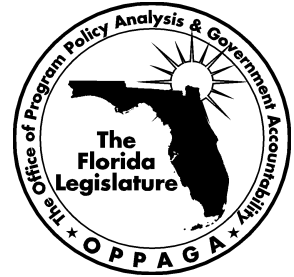
A handwritten signature in black ink, appearing to read 'L. South'.

Linda H. South
Secretary

cc: Ken Granger, Chief of Staff
David Faulkenberry, Deputy Secretary
Sarabeth Snuggs, Director of Retirement
Elizabeth Irvin, Legislative Affairs Director
Linda McDonald, Communications Director

We serve those who serve Florida.

The Florida Legislature
Office of Program Policy Analysis
and Government Accountability



OPPAGA provides performance and accountability information about Florida government in several ways.

- Reports deliver program evaluation, policy analysis, and Sunset reviews of state programs to assist the Legislature in overseeing government operations, developing policy choices, and making Florida government better, faster, and cheaper.
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- Government Program Summaries (GPS), an online encyclopedia, www.oppaga.state.fl.us/government, provides descriptive, evaluative, and performance information on more than 200 Florida state government programs.
- The [Florida Monitor Weekly](#), an electronic newsletter, delivers brief announcements of research reports, conferences, and other resources of interest for Florida's policy research and program evaluation community.
- Visit OPPAGA's website at www.oppaga.state.fl.us

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Gary R. VanLandingham, Ph.D., OPPAGA Director