

**Subcommittee on General Government  
Government Efficiency Task Force**

401 Senate Office Building

May 23, 2012

1:30 p.m. – 3:30 p.m.

- 1) Call to Order
- 2) Roll Call
- 3) Recommendations on the Division of Real Estate
- 4) Public Comment
- 5) Adjourn



# Florida Government Efficiency Task Force

*Subcommittee on General Government*

*Draft Recommendations*

**Subject Matter:** Division of Real Estate

**Subcommittee Members:** Pat Neal (Chair), Senator Mike Bennett, Ann Duncan, Larry Cretul, and Frances Rice

## DRAFT RECOMMENDATIONS

- **State Construction:**

**The Subcommittee recommends utilizing a shared service model for state construction directed by one agency in order to create uniform best practices and achieve cost savings.** Currently, the Division of Real Estate and Management only manages building construction projects in DMS facilities or those projects designated as DMS managed when appropriated to agencies. Building construction staff is located in multiple agencies, there are inconsistencies in contracting, and economies of scale are not leveraged through bundling of similar projects. All agencies involved in building construction should operate a shared services model directed through DMS, allowing for uniform standards, best practices, rules, and procedures for state construction. The state should institute an automatic review process for all state construction projects with a projected cost over a certain threshold. The state should also focus on function, in addition to form, in the design and renovation of state buildings.



# Florida Government Efficiency Task Force

*Subcommittee on General Government*

*Recommendation Analysis*

**Subject Matter:** Florida Retirement System (FRS) Recommendations

**Subcommittee Members:** Pat Neal (Chair), Senator Mike Bennett, Ann Duncan, Larry Cretul, and Frances Rice

## RECOMMENDATION SUMMARY

On May 2, 2012, the Subcommittee on General Government voted to approve the following recommendation regarding the Florida Retirement System (FRS):

- **The Subcommittee recommends defining a goal for the state retirement system.** The state does not currently have a defined goal for the retirement system. The Florida Statutes and Constitution provide requirements, but do not outline a set goal or purpose for the state.
- **The Subcommittee recommends that portability and transferability of retirement funds be placed as a priority.** The DC plan currently offers portability for its members. Due to the changing nature of employment and the increasingly transient nature of employees, the state should place a priority on portability and transferability for all state employee retirement funds.
- **The Subcommittee recommends reviewing the assumed long term returns on the pension fund and the acceptable funding level.** The current assumed return for the FRS pension fund is 7.75%. This assumed rate should be reviewed in context of past market performance to determine if this is an accurate assumption. Various studies have indicated that a funding level of 80% is generally accepted as actuarially sound. As of June of 2011, the FRS pension fund has a funding level of 87.5%. The funding level has many assumptions built in including an assumed rate of return, length of FRS membership, vesting time of benefits. The funding level policy should be reviewed in the context of the potential issues surrounding retirement funds. The subcommittee also recommends that employees contribute a portion of their salary towards their retirement plan.
- **The Subcommittee recommends that a cap be placed on the average salary for calculating pension benefits.** High salaried employees are one of the drivers of increased funding liability for the pension fund. The Internal Revenue Service (IRS) limits the amount of annual salary that may be applied towards retirement under a qualified plan. Currently, the IRS limits the annual salary to \$245,000 for members hired on or after 7/1/96 and \$363,820 for members hired prior to 7/1/96. The Subcommittee recommends a cap on salary applied towards retirement in line with the average salary of a head of state agency, which is \$140,000.
- **The Subcommittee recommends considering a hybrid retirement system.** Various states have either adopted or are considering a hybrid retirement plan (incorporates both DB and DC plans). Florida should review the hybrid option as a method to reduce future unfunded liability, provide flexibility for employees, and ensure adequate guaranteed retirement funds for state employees, particularly lower earning employees.

## FULL ISSUE(S) ANALYSIS

### I. BACKGROUND

#### A. Florida Retirement System:

##### 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.<sup>1</sup> The Florida Retirement System Act<sup>2</sup> governs the FRS, which is a multi-employer plan that provides retirement benefits to 643,680 active members,<sup>3</sup> 319,689 retired members and beneficiaries, and 45,092 members in the Deferred Retirement Option Program (DROP).<sup>4</sup> The FRS is the primary retirement plan for employees of state and county government agencies, district school boards, community colleges, and universities.<sup>5</sup> Participation in the FRS is compulsory for most state employees.<sup>6</sup> The FRS also serves as the retirement plan for participating employees of 185 cities and 243 special districts.<sup>7</sup>

The membership of FRS is divided into five membership classes:

- Regular Class:<sup>8</sup> 561,126 (87.1%)
- Special Risk Class:<sup>9</sup> 72,675 (11.3%)
- Special Risk Administrative Support Class:<sup>10</sup> 63 (0.01%)
- Elected Officers' Class:<sup>11</sup> 2,218 (0.34%)
- Senior Management Service Class:<sup>12</sup> 7,598 (1.2%)<sup>13</sup>

There are currently two retirement programs in which a member of the Florida Retirement System may participate: The Florida Retirement System Pension Plan (defined benefit or DB plan) or the Florida Retirement System Investment Plan (defined contribution or DC plan).

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<sup>1</sup> *The Florida Retirement System Annual Report*, 7/1/10- 6/1/11, pg. 10, [https://www.rol.frs.state.fl.us/forms/2010-11 Annual Report.pdf](https://www.rol.frs.state.fl.us/forms/2010-11%20Annual%20Report.pdf) (last visited 5/15/12). In 1972, the Judicial Retirement system was also consolidated into the FRS.

<sup>2</sup> *See* Ch. 121, F.S.

<sup>3</sup> Information provided by the Department of Management Services, Division of Retirement (information on file with Government Efficiency Task Force staff). Current as of 2/1/12.

<sup>4</sup> *The Florida Retirement System Annual Report* at 22 (as of 6/1/11).

<sup>5</sup> As of June 2011, there were 67 school boards, 28 community colleges, 396 county agencies and 55 agencies of the state participating in the FRS. *Id.* at 38.

<sup>6</sup> Section 121.051, F.S.

<sup>7</sup> *The Florida Retirement System Annual Report* at 38 (as of 6/1/11).

<sup>8</sup> *See* s. 121.021(12), F.S. Regular Class "consists of all members who are not in the Special Risk Class, Special Risk Administrative Support Class, Elected Officers' Class, or Senior Management Class."

<sup>9</sup> *See* s. 121.0515, F.S. Members of this class include law enforcement officers, firefighters, correctional officers, correctional probation officers, paramedics, emergency medical technicians, certain professional health care workers within Department of Corrections and the Department of Children and Family, and certain forensic employees.

<sup>10</sup> *See* s. 121.0515(8), F.S. Members are former members of the special risk class who are transferred or reassigned to an administrative support position in certain circumstances.

<sup>11</sup> *See* s. 121.052, F.S. Members are those who hold specified elective offices in either state or local government.

<sup>12</sup> *See* s. 121.055, F.S. Members are generally high level executive and legal staff or as specifically provided in law.

<sup>13</sup> Information provided by the Department of Management Services, Division of Retirement (information on file with Government Efficiency Task Force staff). Current as of 2/1/12.

### *FRS Pension Plan*

The FRS DB Plan was created in 1970 and is administered by the secretary of the Department of Management Services through the Division of Retirement. Investment management is performed by the State Board of Administration. The DB plan also serves as the default retirement plan membership for all FRS participants. As of July 1, 2011, all active FRS members are required to contribute three percent of their gross salary towards their retirement plan.<sup>14</sup>

A member vests in the pension plan and becomes eligible for lifetime pension benefits after six years of employment with an FRS employer if initially enrolled before July 1, 2011, or after eight years if initially enrolled July 1, 2011, and after.<sup>15</sup> The benefits payable are calculated based on the years of service times the accrual rate times the average final compensation.<sup>16</sup> As of February 29, 2012, the market value of the pension fund was \$126.125 billion.<sup>17</sup>

### *FRS Investment Plan*

In 2000, the Legislature created the FRS Investment Plan (DC plan), a defined contribution plan offered to eligible employees as an alternative to the pension (DB) plan. The earliest any member could participate in the investment plan was July 1, 2002.

The plan is similar to private sector 401(k) plans. Benefits under the investment plan accrue in individual member accounts funded by employee and employer contributions.<sup>18</sup> Benefits are provided through employee directed investments offered by approved investment providers.<sup>19</sup> As of February 29, 2012, the total amount of funds in the investment plan was \$7.067 billion.<sup>20</sup>

### *Employer and Employee Contributions*

Section 121.71, F.S., provides employee and employer contributions to the Florida Retirement System. For FY 2011-12, all active FRS members are required to contribute three percent of their gross compensation, with the exception of members of DROP.<sup>21</sup> The contribution rates to fund normal cost benefits by employers for each membership class for FY 11-12 are:

- Regular Class: 3.28%
- Special Risk Class: 10.21%
- Special Risk Administrative Support Class: 4.07%
- Elected Officers' Class:<sup>22</sup> 7.02%
- Elected Officers' Class:<sup>23</sup> 9.78%
- Elected Officers' Class:<sup>24</sup> 9.27%
- Senior Management Class: 4.81%
- DROP: 3.31%<sup>25</sup>

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<sup>14</sup> See s. 121.71(3), F.S.

<sup>15</sup> See s. 121.021(45)(b), F.S. The eight-year vesting period applies to employees covered under the FRS plan hired after July 1, 2011. The vesting period is six years for employees hired prior to July 1, 2011.

<sup>16</sup> See s. 121.091, F.S.

<sup>17</sup> See <http://www.sbafla.com/fsb/> (last visited 5/15/12).

<sup>18</sup> Section 121.4501(7), F.S. Prior to July 1, 2011, the member accounts were only employer funded.

<sup>19</sup> Section 121.4501(9), F.S.

<sup>20</sup> See <http://www.sbafla.com/fsb/> (last visited 5/15/12).

<sup>21</sup> Section 121.71(3), F.S.

<sup>22</sup> Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, and Public Defenders.

<sup>23</sup> Justices and judges.

<sup>24</sup> County elected officials.

Section 121.71(5), F.S., also provides for employer contributions in order to address unfunded actuarial liabilities of the FRS Pension Plan. The contribution rates for employers for each membership class for FY 11-12 are:

- Regular Class: 0.49%
- Special Risk Class: 2.75%
- Special Risk Administrative Class: 0.83%
- Elected Officers' Class:<sup>26</sup> 0.88%
- Elected Officers' Class:<sup>27</sup> 0.77%
- Elected Officers' Class:<sup>28</sup> 0.73%
- Senior Management Class: 0.32%
- DROP: 0.00%<sup>29</sup>

Employer and employee contributions are contributed monthly to the Division of Retirement and are initially deposited in the Florida Retirement System Contributions Clearing Trust Fund.<sup>30</sup> Allocations to investment plan member accounts are established pursuant to section 121.72(3), F.S., by membership class. For FY 11-12, the allocations for the investment plan members are:

- Regular Class: 9.00%
- Special Risk Class: 20.00%
- Special Risk Administrative Class: 11.35%
- Elected Officers' Class:<sup>31</sup> 13.40%
- Elected Officers' Class:<sup>32</sup> 18.90%
- Elected Officers' Class:<sup>33</sup> 16.20%
- Senior Management Class: 10.95%<sup>34</sup>

After making the allocations required by statute,<sup>35</sup> the remaining balance in the Florida Retirement System Contributions Clearing Trust Fund is transferred to the Florida Retirement Trust Fund to pay the costs of providing pension plan benefits and plan administration.<sup>36</sup> The disability coverage for Investment Plan members is administered by the Division of Retirement and the funding specified in s. 121.71(3), F.S. is transferred to the Florida Retirement System Trust Fund to pay the cost of this benefit.

#### *Employee Participation*

At the time of initial employment, a member of the FRS may choose to either participate in the pension plan or investment plan. If the member does not choose, the default choice is the pension plan. A

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<sup>25</sup> Section 121.71(4), F.S.

<sup>26</sup> Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, and Public Defenders.

<sup>27</sup> Justices and judges.

<sup>28</sup> County elected officials.

<sup>29</sup> Section 121.71(5), F.S.

<sup>30</sup> Section 121.71(2), F.S.

<sup>31</sup> Legislators, Governor, Lt. Governor, Cabinet Officers, State Attorneys, and Public Defenders.

<sup>32</sup> Justices and judges.

<sup>33</sup> County elected officials.

<sup>34</sup> Section 121.72(4), F.S. House Bill 5005, passed during the 2012 session, reduces the contribution levels by approximately 30%. See <http://www.flsenate.gov/Session/Bill/2012/5005/BillText/er/PDF> (last visited 5/15/12).

<sup>35</sup> The allocations include investment member account funds (s. 121.72, F.S.), member disability coverage (s. 121.73, F.S.), and administrative and educational expenses (s. 121.74, F.S.).

<sup>36</sup> Section 121.75, F.S.

member has one additional choice before termination or retirement to change retirement plans. The charts below reflect the current membership of the FRS by class and by retirement plan.<sup>37</sup>

	Class	Members in Pension Plan	Total Salary	Members in Investment Plan	Total Salary
FRS	Regular	472,198	\$18,585,083,221	88,928	\$3,439,293,624
	Senior Management	5,430	\$453,933,974	2,168	\$145,877,359
	Special Risk	61,280	\$3,315,508,794	11,395	\$624,543,868
	Special Risk Admin. Support	45	\$2,070,774	18	\$796,462
	Elected Officer	1,682	\$142,579,733	536	\$26,073,922

The vast majority of FRS members participate in the pension plan (84%) versus the investment plan (16%). The percentage breakdown per class is as follows:

- Regular Class: 84.2% (Pension Plan) and 15.8% (Investment Plan)
- Senior Management Class: 71.5% (Pension Plan) and 28.5% (Investment Plan)
- Special Risk Class: 84.3% (Pension Plan) and 15.7% (Investment Plan)
- Special Risk Admin. Support Class: 71.4% (Pension Plan) and 28.6% (Investment Plan)
- Elected Officer Class: 75.8% (Pension Plan) and 24.2% (Investment Plan)

Member plan choice has been consistent over the last three fiscal years. The chart below shows new employee choice of retirement plans.<sup>38</sup>

Participant Election Data			
New Employee Elections			
	**Default to Pension	Pension Plan	Investment Plan
FY 09-10	21,501 (55.5%)	8,158 (21.1%)	9,071 (23.4%)
FY 10-11	21,049 (52.6%)	9,042 (22.6%)	9,960 (24.8%)
FY 11-12*	6,317 (51.4%)	2,782 (22.7%)	3,179 (25.9%)
Total	48,867 (53.7%)	19,982 (21.9%)	22,210 (24.4%)

\* Percentages are shares of FY Totals as of 12/31/11  
 \*\* Based on focus group and survey data, up to 45% of defaulters use this option as their active plan election choice to the pension plan

<sup>37</sup> Information was provided by the Department of Management Services, Division of Retirement (current as of 2/28/12 and on file with Government Efficiency Task Force staff).

<sup>38</sup> State Board of Administration of Florida, *Monthly Performance Report to the Trustees*, 12/31/11, pg 13 (available with Florida Government Efficiency Task Force).

## Change and Efficiency

### Goal of the Florida Retirement System

The Florida Retirement System does not have an overriding goal in the Constitution or in statute. The Subcommittee provided several questions regarding the purpose of the FRS including:

- What is the state policy regarding the FRS?
- Is the purpose of the FRS for recruitment and retention of state and local employees?
- Is there a comparison between private and public retirement systems that provides a consistent balance between the two?

One articulation of the retirement system was that it was a three prong approach to retirement, where the FRS benefit served as one prong, with social security and personal savings serving as the other two prongs.<sup>39</sup>

### Recommendations

**The Subcommittee recommends defining a goal for the Florida Retirement System.** The state does not currently have a defined goal for the retirement system. The Florida Statutes and Constitution provide requirements, but do not outline a set goal or purpose for the state.<sup>40</sup>

**The Subcommittee recommends that portability and transferability of retirement funds be placed as a priority.** The DC plan currently offers portability for its members. Due to the changing nature of employment and the increasingly transient nature of employees, the state should place a priority on portability and transferability for all state employee retirement funds.

### B. Funding:

The pension plan is funded through a combination of employee and employer contributions and investment earnings. Since the retirement benefits are guaranteed by the state, there is the potential for the pension fund to have a shortfall if the investment earnings are below the projected returns for the long term, or if the actuarially-required contributions are not paid to the system by employees and/or employers.

The pension fund's funding ratio<sup>41</sup> over the last twenty-five years has had a high of 118.1% and a low of 54.3%.<sup>42</sup> A 100% funding ratio indicates that the pension fund is able to meet its liabilities as of the valuation date for current retirees and current members who retire. In 2009, the funding ratio was 88.5%, in 2010 it was 87.9%, and in 2011 it was 87.5%.<sup>43</sup> Experts generally consider public pension

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<sup>39</sup> As provided by Sarabeth Snuggs, Director of the Division of Retirement, at the meeting of the Subcommittee on General Government, May 2, 2012. This is not an official position of DMS, but a common articulation of various pension plans. Ms. Snuggs also noted that a fourth prong would also be any retirement benefits from other employers in the course of the FRS member's career. See <http://www.floridaefficiency.com/meetings.cfm> (last visited 5/8/12).

<sup>40</sup> The Subcommittee does not recommend a particular goal.

<sup>41</sup> A funding ratio is a comparison of a pension's assets to its liabilities (current and future).

<sup>42</sup> See State Board of Administration, *Pension Portfolio Overview as of 6/30/11*, pg. 2 (Copy on file with Government Efficiency Task Force staff).

<sup>43</sup> *Id.* See also [https://www.rol.frs.state.fl.us/forms/Asset\\_Liability\\_Chart.pdf](https://www.rol.frs.state.fl.us/forms/Asset_Liability_Chart.pdf) (last visited 5/15/12). The funding ratio represents assets versus liabilities at a given point in time. The percentages were calculated as of June 30<sup>th</sup> of that year.



plans with funding ratios at or above 80% to be fiscally sound.<sup>44</sup> The economic downturn has shown that state pension funds are vulnerable to market downturns.

## Change and Efficiency

### Funding Ratio Assumptions

In calculating the funding ratios of pension funds, actuaries take several assumptions into consideration including: salary increases, inflation, and investment returns. Most states have an assumed return of around 8 percent.<sup>45</sup> The economic downturn has caused some to question if the assumed rate is too optimistic.<sup>46</sup> The board that oversees the California Public Employees' Retirement System (Calpers) reduced their assumed rate from 7.75% to 7.5%,<sup>47</sup> while the Illinois State Employees' Retirement System lowered their rate from 8.5% to 7.75%.<sup>48</sup> Florida has a return assumption of 7.75%.<sup>49</sup>

The Pew Center report outlines the main debate regarding the assumed return rate:

At the heart of the debate surrounding the appropriate discount rate assumption is whether states should calculate the current value of these long-term promises using an expected rate of return. In other words, if investment returns are disappointing and do not meet expectations, states are still required to pay retirees the benefits they have earned.<sup>50</sup>

The study provides that several experts have recommended a riskless rate instead.<sup>51</sup> Two suggestions were the rate on 30-year treasury bonds<sup>52</sup> or the investment return required by the Final Accounting Standards Board, which is based on corporate bond rates.<sup>53</sup>

If Florida were to use a lower assumed rate of return, the funding ratio would be lower and additional contributions would be needed for the pension fund.<sup>54</sup> Based on the 2009 funding ratio, if the assumed

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<sup>44</sup> U.S. Government Accountability Office (GAO), *State and Local Government Retiree Benefits: Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs*, Report No. 07-1156 (11/07) (Copy on file with Government Efficiency Task Force staff).

<sup>45</sup> The Pew Center on the States, *The Widening Gap: The Great Recession's Impact on State Pension and Retiree Health Care Costs*, April 2011, pg 8, <http://www.pewstates.org/research/reports/the-widening-gap-85899378209> (last visited 5/10/12).

<sup>46</sup> *Id.* Citing Warren Buffett Says That Pension Accounting Encourages Cheating, Bloomberg.com, July 17, 2009, [http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aCb9PTevRP3g&refer=news\\_index](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aCb9PTevRP3g&refer=news_index) (last visited 5/10/12).

<sup>47</sup> *See Calpers Lowers Investment Target to 7.5%*, Wall Street Journal, March 15, 2012, <http://online.wsj.com/article/SB10001424052702304692804577281603950185684.html> (last visited 5/10/12).

<sup>48</sup> *See Illinois Employers Lowers Return Assumption*, Pension & Investments, November 1, 2010, <http://www.pionline.com/article/20101101/PRINTSUB/311019987> (last visited 5/10/12).

<sup>49</sup> This rate of return is assumed over 30 years, since the investment outlook for the pension fund is a long term 15-30 year horizon. The current return for the last 20 years is 7.78%; 15 years is 6.49%; 10 years is 5.19%; 5 years is 1.75%; and 1 year is 0.5%. Information provided by the State Board of Administration (Copy on file with Government Efficiency Task Force staff).

<sup>50</sup> *The Pew Center on the States* at pg. 8.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* As of 5/10/12, the yield on a 30-year treasury bond was 3.08 (at the time of the Pew Study the yield was 4.38). *See* <http://www.bloomberg.com/markets/rates-bonds/government-bonds/us/> (last visited 5/10/12).

<sup>53</sup> *Id.* As of 5/10/12, the yield on a AA Corporate bond was 3.95 (at the time of the Pew Study the yield was 5.22) *See* <http://www.bloomberg.com/quote/MOODCAA:IND> (last visited 5/10/12).

<sup>54</sup> The City of New York recently lowered the assumed rate of return from 8% to 7% on its pension fund, which will result in an additional \$1 billion in contributions to the fund. Moody's gave this action a positive credit outlook, providing that, "While pension costs in the budget will increase, the plan over the long run will lead to greater stability, since using the 7% rate will mitigate market volatility in actuarial calculations of the city's pension liabilities." *See Moody's Welcomes Lower Investment Return Assumptions by Public Pensions*, Market News International, February 13, 2012, <https://mninews.deutsche-boerse.com/index.php/moodys-welcomes->

rate were to be lowered to 5.22% the funding ratio would be 61% and if the rate was lowered to 4.38% the ratio would be 54%.<sup>55</sup>

### Recommendations:

**The Subcommittee recommends reviewing the assumed long-term returns on the pension fund and the acceptable funding level.** The current assumed return for the FRS pension fund is 7.75%. This assumed rate should be reviewed in context of past market performance to determine if this is an accurate assumption.<sup>56</sup> Various studies have indicated that a funding level of 80% is generally accepted as actuarially sound. As of June of 2011, the FRS pension fund has a funding level of 87.5%. The funding level has many assumptions built in, including an assumed rate of return, length of FRS membership, and vesting time of benefits. The funding level policy should be reviewed in the context of the potential issues surrounding retirement funds. The Subcommittee also recommends that employees continue to contribute a portion of their salary towards their retirement plan.

**The Subcommittee recommends that a cap be placed on the average salary for calculating pension benefits.** High-salaried employees are one of the drivers of increased funding liability for the pension fund.<sup>57</sup> The Internal Revenue Service (IRS) limits the amount of annual salary that may be applied towards retirement under a qualified plan.<sup>58</sup> Currently, the IRS limits the annual salary to \$245,000 for members hired on or after July 1, 1996, and \$363,820 for members hired prior to July 1, 1996.<sup>59</sup> The Subcommittee recommends a cap on salary applied towards retirement in line with the average salary of a head of state agency, which is \$140,000.<sup>60</sup>

### C. Government Retirement Systems:

There are three main categories of retirement systems utilized by states:

- **Defined Benefit (DB)** – The traditional public pension structure in which the state (employer) assumes the risk of return and guarantees the employee's payments. The size of the employee's pension is based on a pre-defined equation that includes the employee's duration of service and salary. DB plans use final or greatest salary averages to determine an employee's pensionable salary. As such, the greatest portion of employer liability is accumulated during the latter years of employment.
- **Defined Contribution (DC)** – Similar to the private sector's 401(k) plan. The employee and/or the employer pay a portion of wages into an individual retirement savings account that is

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[lower-invst-return-assump-public-pensions?q=content/moodys-welcomes-lower-invst-return-assump-public-pensions](#) (last visited 5/15/12).

<sup>55</sup> The ratio calculations are based on February 2009 pension figures released by the state and reflect the interest rate for a high end corporate bond (5.22%) and a 30 year US Treasury bond of 3/11. See *Can Investment Assumptions Worsen the State Pension Fund Crisis*, PBS News Hour, June 22, 2011, <http://www.pbs.org/newshour/rundown/2011/06/can-investment-assumptions-worsen-the-state-pension-fund-crisis-1.html> (last visited 5/15/12).

<sup>56</sup> Staff of the State Board of Administration recently suggested reducing the target return by a half a percentage point. See <http://www.thefloridacurrent.com/article.cfm?id=27741971> (last visited 5/20/12).

<sup>57</sup> There are currently 2455 members who make over \$140,000 per year enrolled in the defined benefit plan and 361 members enrolled in the defined contribution plan. Information provided by DMS and on file with the Government Efficiency Task Force staff.

<sup>58</sup> Section 401(a)(17) of the Internal Revenue Code.

<sup>59</sup> *Id.* The amount is based on the original cap of \$150,000 for members employed on or after 7/1/96 and \$250,000 for members employed prior to 7/1/96 and is annually adjusted by the IRS to reflect cost-of-living increases. Salary caps from 1996 to 2011 are on file with the Government Efficiency Task Force staff.

<sup>60</sup> Based on salaries of the Secretary of Transportation, Lottery, Department of Business and Professional Regulation, and Department of Children and Families. Information provided by DMS.

invested per the employee's direction. The eventual retirement benefits are determined by the value of the account. Investment risk is borne entirely by the employee.

Cash Balance (CB) plans are also categorized as DC plans. These combine some elements of DB and DC in that the employer bears the risk of return, but the contributions are made into individual retirement accounts.

- **Hybrid Plans (HP)** – These combine DB and DC plans and can be parallel or stacked. Stacked HP plans offer DB benefits on a prescribed level of income (usually set at no more than the average salary) and enroll employees in an additional DC plan. Employee and employer contributions to the DC portion of the plan can be optional or mandatory. Parallel HPs give the employee the option to save for retirement with a DC plan.

### **Hybrid Retirement Plan**

Four states, Georgia, Indiana, Oregon, and Rhode Island, all operate mandatory HPs. Three states, Ohio, Utah, and Washington, offer optional HPs. States have taken different approaches as to administering the different elements of the plans. Some administer the DB portion themselves but outsource the DC element, whereas others administer both elements. Generally, the employer makes the vast majority, or even all, of the contributions required for the DB portion of the plan, while the employee is required to make a specified contribution to the DC portion.

Advantages of hybrid retirement plans include:

- Provides a guaranteed benefit to the retiree;
- Provides some portability through a DC plan for salary above the average employee salary; and
- The benefit liability of the state is lessened since the salary level is capped.

Disadvantages of hybrid plans include:

- Higher earning employees will have a lower guaranteed benefit; and
- It may be more expensive to administer dual plans as compared to one plan.

### *Rhode Island Hybrid Plan*

Rhode Island is the most recent state to switch to a hybrid retirement plan. Rhode Island was facing an unfunded pension liability of \$7.3 billion, which equated to a 48.4% funding ratio.<sup>61</sup> In 2011, the state adopted a stacked hybrid plan that includes a smaller DB plan with a DC plan. The main difference between Rhode Island and other states is that Rhode Island has enrolled most current employees as well as new employees.

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<sup>61</sup> Ron Snell, *Lessons from Rhode Island: Bold Changes to its Pension Plan Have Caught the Attention of Other States*, National Council of State Legislatures (NCSL), February 2012, <http://www.ncsl.org/issues-research/labor/lessons-from-rhode-island.aspx> (last visited 5/15/12).

Rhode Island estimates that the switch to a hybrid plan will decrease the states unfunded pension liability to \$4.3 billion (approximately 41% decrease) and raise the funding ratio to 59.8%.<sup>62</sup> The pension plan is projected to achieve 80% funding by 2030 for Rhode Island state employees.<sup>63</sup>

## **Change and Efficiency**

### **Types of Retirement Plans Offered**

Florida currently offers a DB plan and a DC plan. The choice of plan is at the discretion of the member. Both plans have advantages and disadvantages for the FRS member and the FRS. The DB plan provides a guaranteed amount of retirement funds for the employee with a longer vesting period, but the FRS retains the liability for providing that amount regardless of market performance. The DC plan provides flexibility and portability for the members and there is no liability for the FRS, but the retirement amount is not guaranteed.<sup>64</sup> The hybrid retirement plan offers the benefits of both plans, while mitigating some of the disadvantages. In the hybrid plan, members receive a lower guaranteed benefit amount than a traditional DB plan, but are supplemented by a DC plan as well. The hybrid plan reduces FRS liability, but continues to provide a reliable source of retirement funds for members.<sup>65</sup>

### **Recommendation:**

**The Subcommittee recommends considering a hybrid retirement system.** Various states have either adopted or are considering a hybrid retirement plan (incorporates both DB and DC plans). Florida should review the hybrid option as a method to reduce future unfunded liability, provide flexibility for employees, and ensure adequate guaranteed retirement funds for state employees.

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<sup>62</sup> Paul Burton, "Rhode Island Makes Reform Happen," *The Bond Buyer*, December 14, 2011, [http://www.bondbuyer.com/issues/120\\_239/rhode-island-pension-1034196-1.html](http://www.bondbuyer.com/issues/120_239/rhode-island-pension-1034196-1.html) (last visited 5/15/12).

<sup>63</sup> *Id.*

<sup>64</sup> The retirement funds are employee directed and may not have a market performance equal or greater than the state pension plan.

<sup>65</sup> There are various different models of the hybrid plan. The Subcommittee does not recommend a particular model. The state should utilize SBA and DMS staff and private sector advisors to determine the benefits of each model for the State of Florida.