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OFFICE OF PROGRAM POLICY ANALYSIS & GOVERNMENT ACCOUNTABILITY

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Compared to Other States, the Pension Plan Is Better Funded, Incurs Lower Investment Fees, and Has Fewer Trustees; Investment Returns Are Average

at a glance

State Board of Administration (SBA) managers have consistently met investment goals for both the Florida Retirement System Pension Plan and Investment Plan, but the SBA's results are average compared to the investment performance of other states. The Pension Plan currently has a funding ratio of 87.9%, and at this time does not have sufficient assets needed to pay current and future expected benefits for participants and their beneficiaries. However, experts generally consider public pension plans with funding ratios at or above 80% to be fiscally sound. The SBA's external manager and brokerage fees are below the average fees paid by other states.

The SBA's three-member board of trustees is smaller than the oversight boards of almost all other states. The SBA has procedures in place for overseeing its investment managers. However, the SBA and the Division of Retirement could improve their reporting on state pension plans by developing a single annual report that provides policymakers with comprehensive financial, investment, actuarial, and statistical information.

Scope

Section 215.44(6), *Florida Statutes*, requires OPPAGA to perform a biennial evaluation of the State Board of Administration's (SBA) management of investments. This report examines the SBA's Florida Retirement System-related investment activities in Fiscal Years 2008-09 and 2009-10, and answers five questions.

1. How well has the SBA invested pension assets and how does its performance compare to other states?
2. What is the funding status of the Pension Plan and how does it compare to other states?
3. How do the investment management fees paid by the SBA compare to those paid by other states?
4. How does the SBA's governance structure compare other states' structures?
5. How does the SBA oversee the Pension Plan and how well does it communicate its investment results to stakeholders?

Background

The State Board of Administration (SBA) is primarily an asset management organization charged by the constitution and state law with investing funds on behalf of state and local governments. The board is composed of the Governor, the Chief Financial Officer, and the Attorney General. These officials serve as trustees to the $133.5 billion in assets under SBA management as of June 30, 2010. An executive director appointed by the trustees oversees the general management of the state's 37 investment funds. The largest of these funds is the Florida Retirement System (FRS) Trust Fund, which as of June 30, 2010, had net assets of $114 billion and comprised 90% of the total assets managed by the board.

FRS Defined Benefit Pension Plan. Established in 1970, this plan allows employees to vest after six years of employment and be eligible for lifetime pension benefits. Pension benefits are based on a formula that takes into account an employee's years of service, salary, age at retirement, and membership class. As of June 30, 2010, this plan had 557,585 active participants and 304,337 retiree annuitants.[1] Active plan participants had an average age of 45 years, 12 years of FRS service, and earned an average salary of $41,582.

The Pension Plan had net asset values of $99.6 billion and $109.3 billion as of June 30, 2009, and June 30, 2010, respectively. Plan assets are managed by 188 external and 21 internal investment managers, with oversight from the board's executive director.

FRS Defined Contribution Investment Plan. The Legislature established the Investment Plan, which is modeled after private sector 401(k) plans, in Fiscal Year 2000-01.[2] This plan requires a one-year vesting period and provides employees 21 investment options. At retirement, employees receive the amount that has accrued from the investments. The amount accrued is based on several factors, including how much employers contribute, the types of investments selected by employees, and how well these investments perform over the employees' careers. As of June 30, 2010, there were 97,782 participants in this plan. Investment Plan participants had an average age of 45 years, 5 years of FRS service, and earned an average salary of $37,132. On average, participants in this plan had $39,462 in their retirement accounts.

The Investment Plan had net asset values of $4.08 billion and $5.05 billion as of June 30, 2009, and June 30, 2010, respectively. Twenty-one external managers, with oversight from the board, manage employees' Investment Plan portfolios.

Two state agencies administer the Pension Plan and Investment Plan. The State Board of Administration and the Department of Management Services' Division of Retirement manage the two retirement plans. The division provides administrative services for the Pension Plan by tracking enrollment, receiving employer contributions, and publishing actuarial and statistical information about the membership in its annual report.[3] The SBA is responsible for investing FRS Pension Plan Trust Fund monies to help ensure that investment returns are sufficient to fund current and future pensioners.[4] The board also administers the defined contribution Investment Plan.

Questions and Answers—

How well has the SBA invested pension assets and how does its performance compare to other states?

The SBA meets its investment goals, but its performance falls in the mid-range when compared to other states. Investment returns are important because the earnings from investments help fund pension benefits. Exhibit 1 shows the historical annualized investment returns for the Pension Plan and the Investment Plan. As shown in the exhibit, the State Board of Administration (SBA) has consistently met its overall investment benchmarks over 1-, 5-, 10-, 15-, and 20-year periods. These benchmarks are based on market indices, economic conditions, and actuarial projections.[5] Investment returns for the individual asset classes, like equities, fixed income, real estate, and cash and short-term securities, are shown in Appendix A for the Pension Plan and the Investment Plan.

[1] Nearly half (48%) of FRS employees are from local school boards, followed by county governments (23%) and state workers (18%). The remaining employees (11%) are from community colleges, state universities, cities, and special districts.

[2] The Investment Plan was first offered to employees in Fiscal Year 2002-03.

[3] For Fiscal Year 2010-11, the division had a legislative appropriation of $36.3 million and 194 authorized positions.

[4] The SBA does not receive an annual legislative appropriation. Its operational and administrative expenses are funded through fees derived from its investment management services and employer contributions to the retirement system. In Fiscal Year 2009-10, the board collected fees of $19,969,854 and had a budget of $30,679,593 and 178.5 authorized positions.

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

Exhibit 1
The SBA's Investment Returns Have Historically Met Its Internal Overall Benchmarks

Pension Plan	Annualized Pension Plan Returns (Net of Fees) as of June 30, 2010					
	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year
Pension Plan Investment Returns	**14.03**	**-4.08**	**2.87**	**2.61**	**7.16**	**8.18**
Benchmark return	11.50	-4.32	2.57	2.23	6.96	7.97
Met or exceeded benchmark?	Yes	Yes	Yes	Yes	Yes	Yes

Investment Plan	Annualized Investment Plan Return (Net of Fees) as of June 30, 2010					
	1-Year	3-Year	5-Year	Since Inception	15-Year	20-Year
Investment Plan Returns	**11.07**	**-3.52**	**2.80**	**5.63**[1]	–[2]	–[2]
Benchmark return	10.32	-4.28	2.20	5.28[1]	–[2]	–[2]
Met or exceeded benchmark?	Yes	Yes	Yes	Yes	–[2]	–[2]

[1] These results are since the Investment Plan was offered to employees in Fiscal Year 2002-03.

[2] The Investment Plan was implemented in 2002; consequently, 10-, 15-, and 20-year returns are not available.

Source: State Board of Administration investment data.

The SBA's overall investment performance is average compared to other states' pension plans with a July 1 through June 30 fiscal year (see Exhibit 2). Eight of these states (Connecticut, Idaho, Iowa, Nevada, New Jersey, North Carolina, West Virginia, and Wisconsin) had higher overall return rates than the SBA over 1-, 5-, and 10-year periods. In contrast, the SBA had higher overall return rates than five states (Illinois, Maryland, Mississippi, Montana, and Rhode Island) for each of these same periods. The investment performance of the remaining states varied; for example, the SBA had a higher overall 1-year return than Missouri, but achieved lower returns over 5-year and 10-year periods.[6]

[6] These results are consistent with those reported in a 2010 private study that compared the SBA's returns over a 5-year period to those of private and public pension plans with assets between $32 billion and $203 billion. Please see *Investment Cost Effectiveness Analysis for the Five Years Ending December 31, 2009*, CEM Benchmarking Inc., November 4, 2010.

Exhibit 2
The SBA's Investment Returns Are Average Compared to Other States[1]

Rank Order—1-Year Investment Returns	
Wyoming[2]	23.80%
Nebraska[2]	22.10%
Ohio[2]	19.09%
Massachusetts[2]	18.22%
Colorado[2]	17.40%
Utah[2]	12.88%
Pennsylvania[2]	9.10%
Michigan[3]	-6.10%
Texas[6]	-6.60%
Alabama[3]	-10.03%
Georgia	-12.97%
North Carolina	-14.20%
New Jersey	-14.27%
Tennessee	-15.27%
Oklahoma	-15.40%
Nevada	-15.60%
West Virginia	-15.60%
Delaware	-15.80%
Idaho	-16.00%
Iowa	-16.27%
Kentucky	-17.22%
Wisconsin	-17.70%
Arizona	-18.10%
New Hampshire	-18.10%
Connecticut	-18.25%
Vermont[7]	-18.70%
Maine	-18.80%
Florida	**-19.03%**
South Carolina	-19.04%
Louisiana	-19.10%
Missouri	-19.10%
Mississippi	-19.40%
Minnesota	-19.60%
Kansas	-19.64%
Maryland	-20.00%
Illinois	-20.10%
Rhode Island	-20.10%
South Dakota	-20.36%
Indiana	-20.60%
Alaska	-20.62%
Montana	-20.69%
Arkansas[7]	-20.89%
Virginia	-21.10%
Oregon	-22.30%
Washington	-22.84%
California	-24.00%
New Mexico	-24.11%
North Dakota	-24.50%
New York[4]	-26.38%
Average State Return	**-18.94%**
Median State Return	**-19.10%**

Rank Order—5-Year Investment Returns	
Texas[6]	4.48%
Michigan[3]	4.20%
Missouri	4.20%
Washington	4.05%
Pennsylvania[2]	4.00%
Massachusetts[2]	3.97%
Colorado[2]	3.90%
Idaho	3.70%
Delaware	3.60%
Iowa[2]	3.50%
Ohio[2]	3.50%
Utah[2]	3.41%
Nebraska[2]	3.30%
New Jersey	3.14%
Oregon	2.90%
Wisconsin	2.90%
Louisiana	2.70%
Virginia	2.70%
Wyoming[2]	2.70%
Kansas	2.69%
Minnesota	2.60%
North Carolina	2.60%
Oklahoma	2.40%
West Virginia	2.40%
Alaska	2.20%
Connecticut	2.20%
Nevada	2.20%
Florida	**2.17%**
Rhode Island	2.05%
Georgia	2.00%
Arkansas[7]	1.92%
Maine	1.90%
Kentucky	1.84%
New Hampshire	1.80%
Tennessee	1.68%
North Dakota	1.63%
California	1.60%
Alabama[3]	1.59%
Maryland	1.50%
Illinois	1.40%
Mississippi	1.40%
Vermont[7]	1.40%
Arizona	1.20%
New York[4]	1.11%
Indiana	1.10%
Montana	0.88%
New Mexico	0.37%
South Carolina	0.16%
South Dakota	–[5]
Average State Return	**2.19%**
Median State Return	**2.20%**

Rank Order—10-Year Investment Returns	
Missouri	4.30%
Utah[2]	4.24%
Delaware	4.20%
Iowa	3.91%
Pennsylvania[2]	3.90%
Idaho	3.80%
Michigan[3]	3.70%
Nebraska[2]	3.60%
South Carolina	3.60%
South Dakota	3.60%
West Virginia	3.60%
Wisconsin	3.60%
Ohio[2]	3.54%
North Carolina	3.40%
Colorado[2]	3.30%
Louisiana	3.30%
Kansas	3.25%
Virginia	3.20%
Nevada	3.10%
New York[4]	3.06%
Connecticut	2.91%
Wyoming[2]	2.80%
North Dakota	2.69%
Alabama[3]	2.67%
Vermont[7]	2.50%
Minnesota	2.40%
California	2.30%
Maine	2.30%
New Jersey	2.30%
Florida	**2.29%**
Kentucky	2.26%
New Hampshire	2.10%
Arizona	1.90%
Illinois	1.90%
Maryland	1.90%
Rhode Island	1.83%
Mississippi	1.80%
Montana	1.79%
Alaska	–[5]
Arkansas[7]	–[5]
Georgia	–[5]
Indiana	–[5]
Massachusetts[2]	–[5]
New Mexico	–[5]
Oklahoma	–[5]
Oregon	–[5]
Tennessee	–[5]
Texas[6]	–[5]
Washington	–[5]
Average State Return	**2.86%**
Median State Return	**2.91%**

[1] Returns are net of fees unless otherwise indicated. Like Florida, most states' fiscal years are from July 1 through June 30. Those states whose fiscal years do not match Florida's are not included in the calculation of average and median investment performance, but are presented here for informational purposes only. Hawaii was excluded because it had not published its Fiscal Year 2008-09 annual report by the completion of our fieldwork.

[2] The state's fiscal year is from January 1 through December 31.

[3] The state's fiscal year is from October 1 through September 30.

[4] The state's fiscal year is from April 1 through March 31.

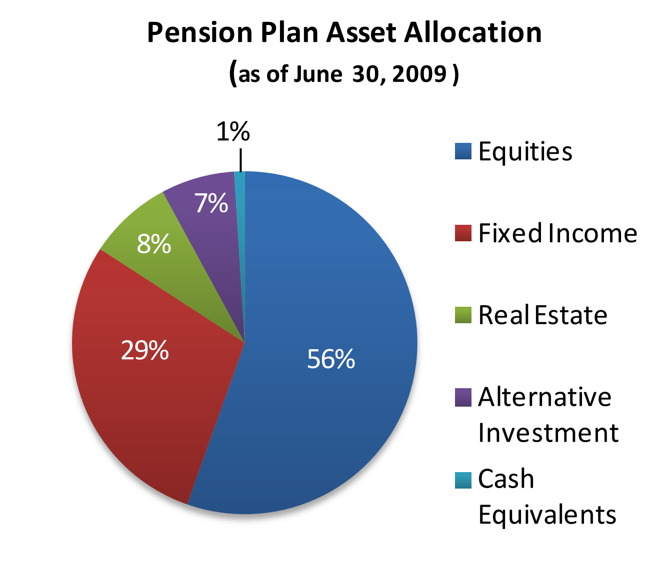
[5] The state did not report investment results for this period.

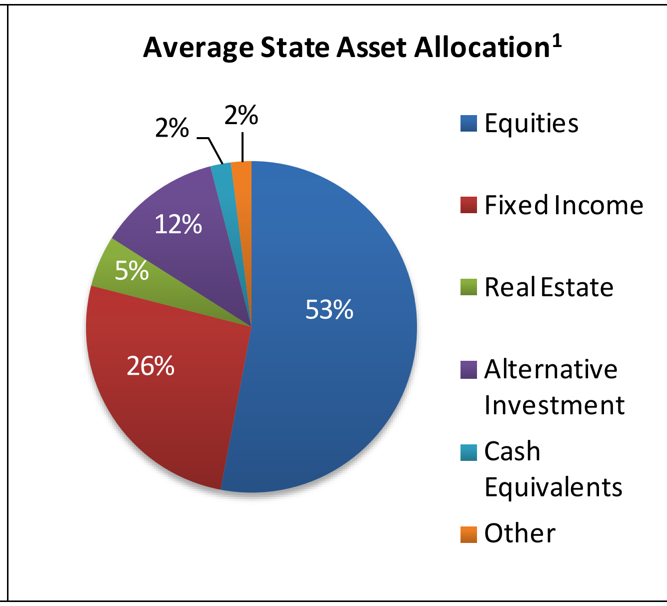
[6] The state fiscal year is from September 1 through August 31.

[7] Investment returns for Arkansas and Vermont are gross of fees and they are not included in any comparison calculations.

Source: States' investment performance reports for Fiscal Year 2008-09.

Exhibit 3
The Pension Plan Has a Higher Percentage of Assets Allocated to Equities, Fixed Income, and Real Estate than Other State Pension Plans





[1] Seven states were excluded from this analysis. Idaho, Nebraska, and Wyoming were excluded from this analysis because they reported only their target asset allocation and not their actual allocation. Georgia was excluded because it did not report its allocation in a manner similar to other states. Kansas and Maryland were excluded because they did not report the value of assets in each asset class. Hawaii was excluded because it had not published its Fiscal Year 2008-09 annual report by the completion of our fieldwork.

Source: States' investment performance reports for Fiscal Year 2008-09.

Asset allocation, the distribution of a pension plan's assets among various investment classes such as equities, fixed income, real estate, and cash, is the primary determinant of the plan's long-term investment performance. Relatively minor differences in asset allocation can significantly affect a fund's investment performance over the long-term.

As shown in Exhibit 3, the Pension Plan's asset allocation differs from the average state asset allocation in that it has a higher percentage of its assets invested in equities, fixed income, and real estate, and a smaller percentage in alternative investments.

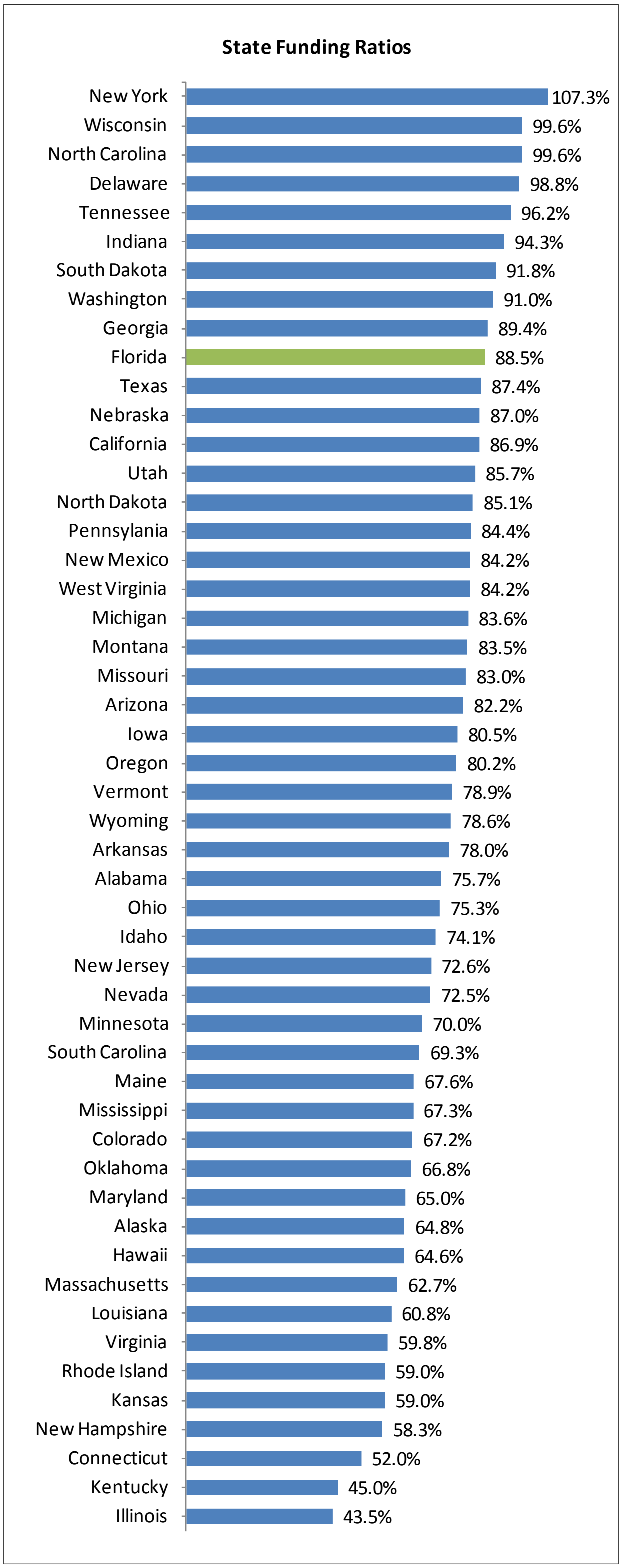
What is the funding status of the Pension Plan and how does it compare to other states?

The Pension Plan's liabilities exceed its assets, but the plan is still fiscally sound. As of June 30, 2010, the Pension Plan's funding ratio (i.e., the ratio of the actuarial value of the plan's assets to the actuarial value of benefits owed to members and their beneficiaries) was 87.9%. This means that at this time, the plan does not have sufficient assets needed to pay current and future expected benefits for participants and their beneficiaries. Actuarially, the plan has a shortfall of $16.7 billion.[7] However, experts generally consider public pension plans with funding ratios at or above 80% to be fiscally sound.[8]

[7] The shortfall, referred to as an unfunded actuarial liability, is due to lower than expected investment results. By law, the shortfall must be amortized over a 30-year period.

[8] *State and Local Government Retiree Benefits: Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs*, U.S. Government Accountability Office (GAO) Report No. 07-1156, Revised November 2007.

Exhibit 4
Almost All State Pension Plans Had Funding Ratios Below 100% in Fiscal Year 2008-09



Source: States' investment performance reports for Fiscal Year 2008-09.

Exhibit 4 shows that most states are currently facing similar funding challenges. According to the most recent available data (Fiscal Year 2008-09), half of the states' pension plans fall below the 80% threshold. See Appendix B for the historical funding status of the Pension Plan and Appendix C for each state's asset allocation.

How do the investment management fees paid by the SBA compare to those paid by other states?

The SBA's external manager and brokerage fees are below the average fees paid by other states. The SBA pays fees and commissions to external investment firms and brokerages to select, purchase, and manage a portion of the Pension Plan's assets. These fees totaled approximately $306 million in Fiscal Year 2008-09.

Thirty-five states published fees and commissions in their Fiscal Year 2008-09 investment reports, the most recent data available for nearly all states. As shown in Exhibit 5, the ratio of the SBA's fees and commissions to the Pension Plan's net assets was 0.317%, which was below the average and median ratios of other states' pension plans (0.443% and 0.405%, respectively). These results are consistent with those we reported in our 2009 report and the results of a 2010 private study commissioned by the SBA for private and public pension plans whose assets ranged from $32 billion to $203 billion.[9]

[9] *Retirement Fund Investments Decline with the Economy But Still Meet Several Performance Benchmarks; SBA Must Improve Communication with its Stakeholders*, OPPAGA Report No. 09-16, March 2009; *Investment Cost Effectiveness Analysis for the 5 Years Ending December 31, 2009*, CEM Benchmarking Inc., November 4, 2010.

Exhibit 5
Florida Pension Plan's External Investment Management Fees Are Lower than Average

State[1]	Fees and Commissions Paid (in thousands)	Total Net Assets (in thousands)	Fees and Commissions as a Percentage of Net Assets
New Jersey	$ 26,992	$69,903,913	0.039%
Texas	18,454	19,942,784	0.093%
Oklahoma	6,650	5,173,538	0.129%
Tennessee	34,285	26,369,226	0.130%
Iowa	25,198	17,974,038	0.140%
Nevada	27,840	18,770,137	0.148%
Maine	18,972	8,309,748	0.228%
Kansas	23,944	10,214,875	0.234%
South Carolina	48,127	20,492,378	0.235%
Ohio	142,517	57,630,425	0.247%
Utah	45,490	17,717,845	0.257%
New Mexico	24,203	8,795,819	0.275%
Mississippi	44,898	15,134,487	0.297%
Florida	**305,953**	**96,632,476**	**0.317%**
California	581,302	178,899,883	0.325%
Michigan	121,075	34,498,379	0.351%
New York	381,923	94,242,344	0.405%
Maryland	120,895	28,570,474	0.423%
New Hampshire	19,595	4,315,256	0.446%
Arkansas	19,595	4,349,813	0.450%
Idaho	41,006	8,888,352	0.461%
Arizona	110,427	19,506,243	0.566%
Delaware	31,368	5,392,660	0.582%
Louisiana	41,731	7,100,334	0.588%
Washington	331,605	51,923,648	0.639%
Oregon	290,268	42,904,809	0.677%
Virginia	296,000	39,889,754	0.702%
Indiana	69,059	9,442,336	0.731%
Connecticut	158,749	20,382,166	0.779%
Kentucky	20,584	3,584,601	0.574%
South Dakota	45,835	5,648,767	0.811%
Missouri	54,424	6,163,087	0.883%
Pennsylvania	265,244	24,661,949	1.076%
Average for Other States	**$108,170**	**$26,472,435**	**0.443%**
Median for Other States	**$45,490**	**$18,770,137**	**0.405%**

[1] Fifteen states did not report their commissions and fees and were not included in our analyses: Alaska, Colorado, Georgia, Illinois, Massachusetts, Minnesota, Montana, Nebraska, North Carolina, North Dakota, Rhode Island, Vermont, West Virginia, Wisconsin, and Wyoming. We did not include information for Alabama because it primarily uses internal managers. Hawaii was excluded because it had not published its Fiscal Year 2008-09 annual report by the completion of our fieldwork.

[2] Fees include brokerage commissions and external management fees and exclude management consultant, legal, and custodial fees. These fees are for each state's defined benefit plan only, as not every state-administered plan provides a defined contribution option for its employees.

Source: State pension systems' annual reports for Fiscal Year 2008-09.

How does the SBA's governance structure compare to other states' structures?

Florida's board of trustees is smaller than the oversight boards in most other states. The constitution establishes the Governor, Chief Financial Officer, and Attorney General as the State Board of Administration and, as required by law, they serve as trustees for the funds managed by the SBA. They are required by law to meet at least quarterly, but typically meet monthly to discuss fund management issues.

As shown in Exhibit 6, nearly every other state has a larger oversight body than Florida. The only state with fewer trustees is New York, which has one trustee. On average, states have 10 trustees, 5 of whom are appointed, 2 are ex-officio members by virtue of their positions within state and/or local government, and 3 represent retired and active retirement system members. Thirty-nine states have active and retired plan participants serving as trustees; plan members in 18 states elect these trustees. In addition, 14 states (Arizona, Georgia, Iowa, Maine, Michigan, Nebraska, New Hampshire, Ohio, Oklahoma, Oregon, Utah, Virginia, Wisconsin, and Wyoming) require one or more trustees to have investment expertise.

Exhibit 6
The SBA Has Fewer Trustees than Nearly All Other States

State	Pension Plan Trustees	Trustee Appointees	Ex-Officio Trustees	Employees/Retirees Serving as Trustees
Tennessee	20	5	9	6[1]
South Dakota	17	2	1	14[1]
Colorado	16	3	2	11[1]
Connecticut	16	15	1	6
West Virginia	16	12	4	8
Rhode Island	15	4	4	7[1]
Maryland	14	6	3	5[1]
New Hampshire	14	13	1	0
North Carolina	14	12	2	0
Alabama	13	3	4	7[1]
California	13	3	4	6[1]
Illinois	13	6	1	6
Oklahoma	13	8	5	0
Louisiana	12	0	3	9[1]
Michigan	12	2[2]	1	9
New Mexico	12	0	2	10
Iowa	11	10	1	3
Minnesota	11	5	1	5[1]
Missouri	11	6	2	3[1]
Ohio	11	3	1	7
Pennsylvania	11	10	1	0
Wyoming	11	10	1	5
Mississippi	10	1	1	8[1]
Washington	10	7	3	5
Alaska	9	7	2	4
Arizona	9	9	0	5
Arkansas	9	6	3	6
Kansas	9	6	1	2
Kentucky	9	3	1	5[1]
New Jersey	9	9	1	6[1]
Virginia	9	9	0	4
Wisconsin	9	8	1	2
Hawaii	8	3	1	4[1]
Maine	8	4	1	3[1]
Vermont	8	1	3	4[1]
Delaware	7	5	2	0
Georgia	7	1	3	2
Montana	7	7	0	0
Nebraska	7	5	2	0
Nevada	7	7	0	7
North Dakota	7	3	0	4[1]
Utah	7	6	1	2
Indiana	6	5	1	2
Texas	6	3	0	3[1]
Idaho	5	5	0	0
Massachusetts	5	1	1	2[1]
Oregon	5	5	0	2
South Carolina	5	0	5	0
Florida	**3**	**0**	**3**	**0**
New York	1	0	1	0
Average	**10**	**5**	**2**	**3**

[1] Active participants and retirees serving as trustees are elected in this state.

[2] In Michigan, the governor appoints an additional nine trustees drawn from the plan's membership.

Source: Information from other states' websites, annual reports, and statutes.

Expert opinions vary regarding the ideal size of pension system boards of trustees. The Government Finance Officers' Association's best practices on the governance of public pension systems recommend that boards have between 7 and 13 members, depending on a system's size and complexity. However, private sector managers of foundations and endowments interviewed by SBA managers reported that the ideal size of a board is between four and eight trustees.[10]

Public and private sector managers agree on several fundamental principles regarding boards of trustees. For example, both public and private sector representatives agreed that boards of trustees should

- have clearly defined roles;
- implement succession planning that preserves institutional memory; and
- participate in a program of continued training regarding their fiduciary roles.

In addition, private sector managers reported that trustees should develop high-level investment policies but leave day-to-day investment activities to executive staff. The Government Finance Officers' Association emphasized the importance of the composition of trustee boards and recommended that they include active and retired system members, officers of the plan sponsors, and citizens of the government units to help ensure balanced deliberations and decision-making.

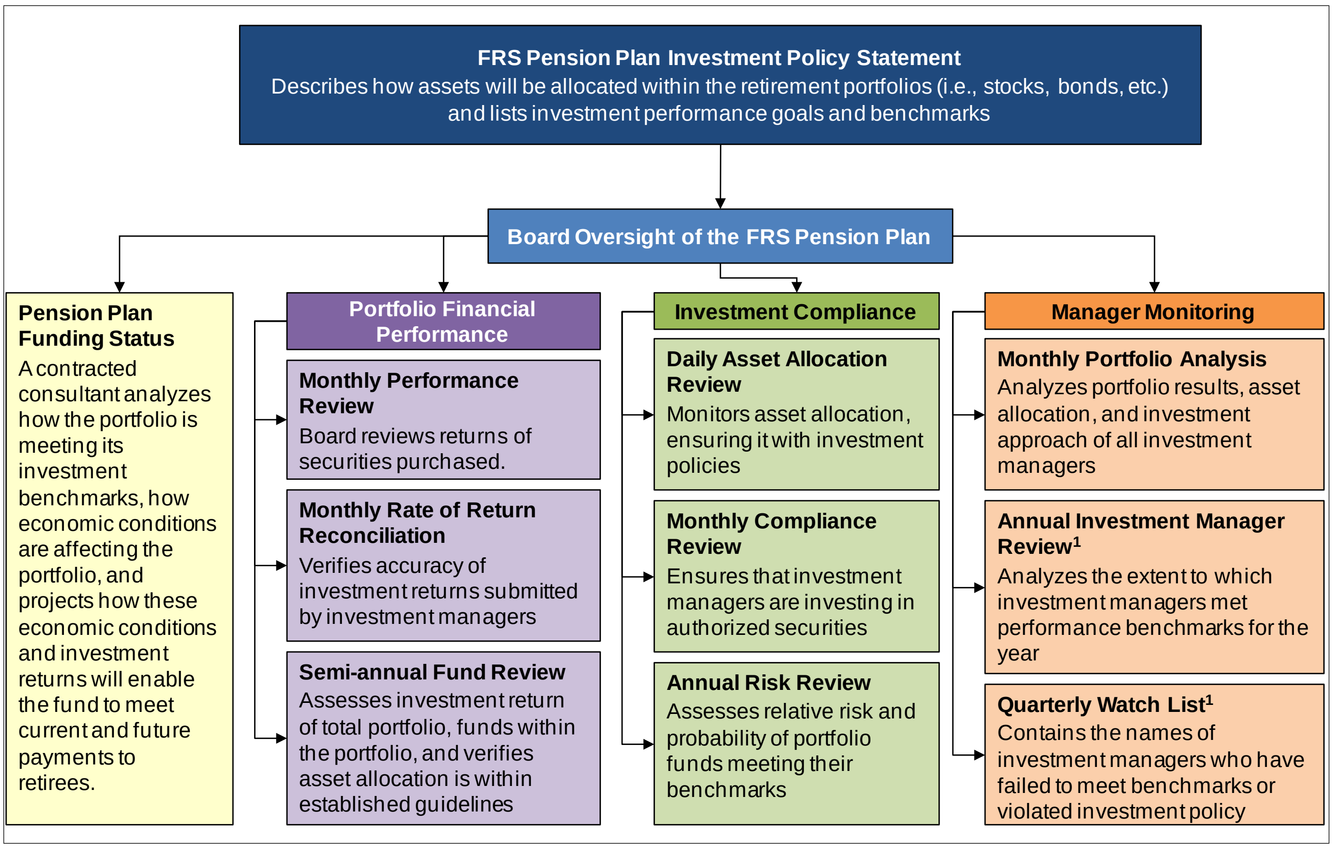
How does the SBA oversee the Pension Plan and how well does it communicate its investment results to stakeholders?

Several oversight procedures are in place, but communication with stakeholders needs improvement. The SBA has several procedures in place to oversee the Florida Retirement System's Pension Plan. As shown in Exhibit 7, SBA managers routinely monitor the funding status of the Pension Plan, evaluate the financial performance of both the Pension Plan

[10] *Governance Research Project,* Florida State Board of Administration, September 8, 2009.

and Investment Plan, and monitor the performance of fund managers. Moreover, in December 2009, board managers responded to an independent consultant's recommendation to segregate its investment management and oversight responsibilities by creating an independent compliance unit with staff dedicated to ensuring investment managers comply with oversight procedures. A chief compliance officer who reports directly to the executive director on these issues heads this unit. In addition, the Division of Retirement monitors the Pension Plan's funding status through its contracted actuary, which is required to report annually on the ability of system assets to cover liabilities.

Exhibit 7
SBA Has Various Monitoring Procedures to Oversee the FRS Pension Plan



[1] With the exception of Real Estate Investment Trust accounts, there is no watch list or annual review of investment managers for the real estate and private equity portfolios because these investments are not traded in the public markets, are generally held for the long term (10 years), and are generally illiquid in nature.

Source: State Board of Administration.

The SBA also publishes an annual investment report, which serves as its primary report to stakeholders. This report provides useful information on the investment of Pension Plan and Investment Plan assets. For example, it provides information on investment returns compared against a benchmark index as well as information on how it compares to other private and public plans in costs and fees. However, the SBA and the Division of Retirement could improve their reporting to stakeholders on the status of these plans.

The Government Finance Officers' Association has published guidelines to help states meet standards of openness, transparency, and accountability in their annual pension plan reports. These guidelines recommend that such reports provide a range of financial and investment information, such as

- progress in bringing the plan to full funding and whether pension assets can meet pension obligations;
- the assumed actuarial rate of return and the method used to value plan assets;
- actual investment returns achieved for all asset classes against benchmarked indices;
- the plan's largest investment holdings with information indicating where a complete listing of holdings can be obtained;
- fees and brokerage commissions paid;
- basic financial statements; and
- member information, including the classes of employees covered and current membership, the number of retirees and others currently receiving benefits, terminated employees entitled to receive benefits in the future, and current active plan members.

The association has awarded certificates of achievement for excellence in reporting to 40 state pension plans for their comprehensive annual financial reports.

Florida does not currently provide the information recommended by the Government Finance Officers' Association in a single comprehensive report. This is because much of the required information is contained in separate reports issued by the SBA and the Division of Retirement. For example, the SBA's annual investment report includes information on its investment results for all asset classes compared to benchmarked market indices, while the division's annual report provides actuarial information such as the ability of assets to cover pension obligations and the assumed actuarial return, the method used to value plan assets, and demographic information on FRS members. Moreover, while the division's report includes a section on finance and investments, the section provides limited information about the SBA's investment performance and directs the reader to the SBA's annual investment report. Such fragmented reporting is not consistent with the Government Finance Officers' Association's reporting guidelines and the practices followed by the majority of other states. Similar to Florida, New Jersey, and Washington have state pension plans for which administration and investment responsibilities are assigned to different entities. Nonetheless, each of these states issues one comprehensive annual report that conforms to association guidelines.

We recommend that the SBA work with the Division of Retirement to develop a single, comprehensive annual report that would provide information specified in the Government Finance Officers' Association's guidelines. The publication of a comprehensive annual report containing investment, financial, and demographic information would help policymakers as they consider pension reform and enable them to more readily evaluate current plan oversight, funding, and investment policies and performance.

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 and CIO of the State Board of Administration and the Secretary of the Department of Management Services. Both responses have been reproduced in Appendix D.

OPPAGA supports the Florida Legislature by providing data, evaluative research, and objective analyses that assist legislative budget and policy deliberations. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021 or 800/531-2477), by FAX (850/487-3804), in person, or by mail (OPPAGA Report Production, Claude Pepper Building, Room 312, 111 W. Madison St., Tallahassee, FL 32399-1475). Cover photo by Mark Foley.

OPPAGA Website: www.oppaga.state.fl.us

Project supervised by Kara Collins-Gomez (850/487-4257)
Project conducted by Linda Vaughn
Kathy McGuire, Interim OPPAGA Director

Appendix A

Investment Returns for the Pension Plan and Investment Plan

The SBA generally meets its benchmarks within each of the asset classes. As shown in Table A-1, the Pension Plan's investment performance for specific asset classes is mixed. The most consistent performers have been domestic and foreign equities and real estate. The weakest performing asset class is cash and short-term securities.

Table A-1
Pension Plan Investment Returns Have Generally Met Benchmarks

Asset Class	Historical Pension Plan Returns by Asset Class (Net of Fees) June 30, 2010					
	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year
Pension Plan Investment Returns	**14.03**	**-4.08**	**2.87**	**2.61**	**7.16**	**8.18**
Benchmark return[1]	11.50	-4.32	2.57	2.23	6.96	7.97
Met or exceeded benchmark?	Yes	Yes	Yes	Yes	Yes	Yes
Domestic Equities – Stocks exclusively from U.S. companies	15.89	-9.34	-0.57	-0.99	6.44	7.84
Benchmark return[2]	15.72	-9.47	-0.48	-1.11	6.36	7.70
Met or exceeded benchmark?	Yes	Yes	No	Yes	Yes	Yes
Foreign Equities – Stocks exclusively from countries outside of the U.S.	**14.18**	**-9.09**	**4.28**	**3.18**	**6.03**	**N/A**
Benchmark return[3]	11.88	-10.31	3.65	2.06	4.81	N/A
Met or exceeded benchmark?	Yes	Yes	Yes	Yes	Yes	N/A
Fixed Income – Investments that yield a regular (or fixed) return, e.g., bonds	**14.89**	**7.32**	**5.64**	**6.65**	**6.56**	**7.56**
Benchmark return[4]	9.50	7.55	5.68	6.57	6.52	7.51
Met or exceeded benchmark?	Yes	No	No	Yes	Yes	Yes
Real Estate – Office, retail, industrial, and apartment buildings as well as real estate investment trusts, which are publicly traded real estate securities	**-10.15**	**-8.35**	**2.00**	**6.80**	**8.14**	**6.09**
Benchmark return[5]	-12.14	-9.93	-3.24	3.35	5.36	5.65
Met or exceeded benchmark?	Yes	Yes	Yes	Yes	Yes	Yes
Cash and Short-Term Securities – High quality securities that can be sold within less than one year without a loss of value	**1.96**	**-0.90**	**1.37**	**2.05**	**3.31**	**3.97**
Benchmark return[6]	0.37	2.16	3.22	2.86	3.67	3.93
Met or exceeded benchmark?	Yes	No	No	No	No	Yes
Private Equity – Stocks in companies that are not publicly traded on a stock exchange	**21.44**	**-1.34**	**4.23**	**2.26**	**6.29**	**8.48**
Benchmark return[7]	20.20	-3.74	4.56	3.77	8.24	12.75
Met or exceeded benchmark?	Yes	Yes	No	No	No	No
High Yield – Bonds that have a high potential of return to compensate for their higher risk	**19.61**	**5.63**	–[9]	–[9]	–[9]	–[9]
Benchmark return[8]	20.85	5.91	–[9]	–[9]	–[9]	–[9]
Met or exceeded benchmark?	No	No	–[9]	–[9]	–[9]	–[9]

Asset Class	Historical Pension Plan Returns by Asset Class (Net of Fees) June 30, 2010					
Strategic Investments – Real estate debt, city, county, and state infrastructure projects, timber land, and corporate governance activist funds designed to improve returns on undervalued companies	**28.88**	**-8.41**	–[9]	–[9]	–[9]	–[9]
Benchmark return[10]	10.86	-7.51	–[9]	–[9]	–[9]	–[9]
Met or exceeded benchmark?	Yes	No	–[9]	–[9]	–[9]	–[9]

[1] The Pension Plan uses as its index a weighted blend of individual asset class target indices established by the FRS Pension Plan Investment Policy Committee.

[2] The domestic equities benchmark is the Russell 3000 Index.

[3] The foreign equities benchmark is the Customized Morgan Stanley Capital International ACWI Investable Market Index.

[4] The fixed income benchmark is the Barclays Capital U.S. Aggregate Bond Index.

[5] The Real Estate portfolio uses as its index an average of the National Council of Real Estate Investment Fiduciaries Fund Index – Open-Ended Diversified Core Equity, gross of fees, weighted at 90%, and the Wilshire Real Estate Securities index, weighted at 10%.

[6] The cash equivalents fund uses as its benchmark the iMoneyNet First Tier Institutional Money Market Funds Gross Index.

[7] The private equity benchmark is the Russell 3000 Index plus 450 basis points.

[8] The high yield benchmark is the Barclays Capital U.S. High Yield Ba/B 2% Issuer Capped Index.

[9] This fund was not in existence during this period.

[10] The strategic investments benchmark is a weighted blend of individual portfolio level benchmark returns.

Source: State Board of Administration.

As shown in Table A-2, investment managers meet their benchmarks for most assets classes within the Investment Plan. However, as with the Pension Plan, Investment Plan investments in cash equivalents and short-term securities continue to underperform the benchmark.

Table A-2
Investment Plan Historical Investment Returns Have Generally Met Financial Market Targets

Asset Class	FRS Investment Plan Returns by Asset Class June 30, 2010			
	1-Year	3-Year	5-Year	Since 2002 Inception
Investment Plan Investment Returns	11.07%	-3.52	2.80	5.63
Benchmark return[1]	10.32%	-4.28	2.20	5.28
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
Domestic Equities - Stocks exclusively from U.S. companies	18.62%	-8.44	0.44	5.19
Benchmark return[2]	17.58%	-9.24	-0.18	4.97
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
Foreign/Global Equities - Stocks from both the U.S. and foreign countries	8.40%	-10.17	2.83	7.84
Benchmark return[3]	8.03%	-12.31	1.04	6.46
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
Fixed Income - Investments that yield a regular (or fixed) return, e.g., bonds	12.28%	8.10	6.03	6.02
Benchmark return[3]	10.40%	7.10	5.46	5.59
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
Treasury Inflation-Protected Securities - Inflation-indexed bonds issued by the U.S. Treasury whose interest rate is linked to inflation	9.61%	7.78	5.06	6.48
Benchmark return[5]	9.52	7.62	4.98	6.48
Met or exceeded benchmark?	Yes	Yes	Yes	Yes
Cash and Short-Term Securities - Cash and high quality securities that that can be sold in less than one year with little loss of value	0.23%	1.81	3.06	2.56
Benchmark return[6]	0.37	2.16	3.25	2.67
Met or exceeded benchmark?	No	No	No	No
Balanced Fund - Stocks, bonds, and money market funds	10.53	-3.67	2.85	5.73
Benchmark return[7]	10.26	-4.16	2.46	5.58
Met or exceeded benchmark?	Yes	Yes	Yes	Yes

[1] The Investment Plan uses as its index a weighted blend of individual asset class target indices established by the FRS Plan Policy Statement.

[2] The domestic equities benchmark is an exposure-weighted blend of the benchmark returns for each portfolio in the asset class.

[3] The foreign equities benchmark is an exposure-weighted blend of the benchmark returns for each portfolio in the asset class.

[4] The fixed income benchmark is an exposure-weighted blend of the benchmark returns for each portfolio in the asset class.

[5] The Treasury Inflation Protected Securities fund uses the Barclays Capital U.S. Treasury Inflation Note Index.

[6] The cash equivalents fund uses as its benchmark the iMoneyNet First Tier Institutional Money Market Funds Gross Index.

[7] The balanced fund benchmark is composed of the underlying or constituent funds' benchmarks, weighted to reflect the optimal shares for the particular balanced fund's respective target.

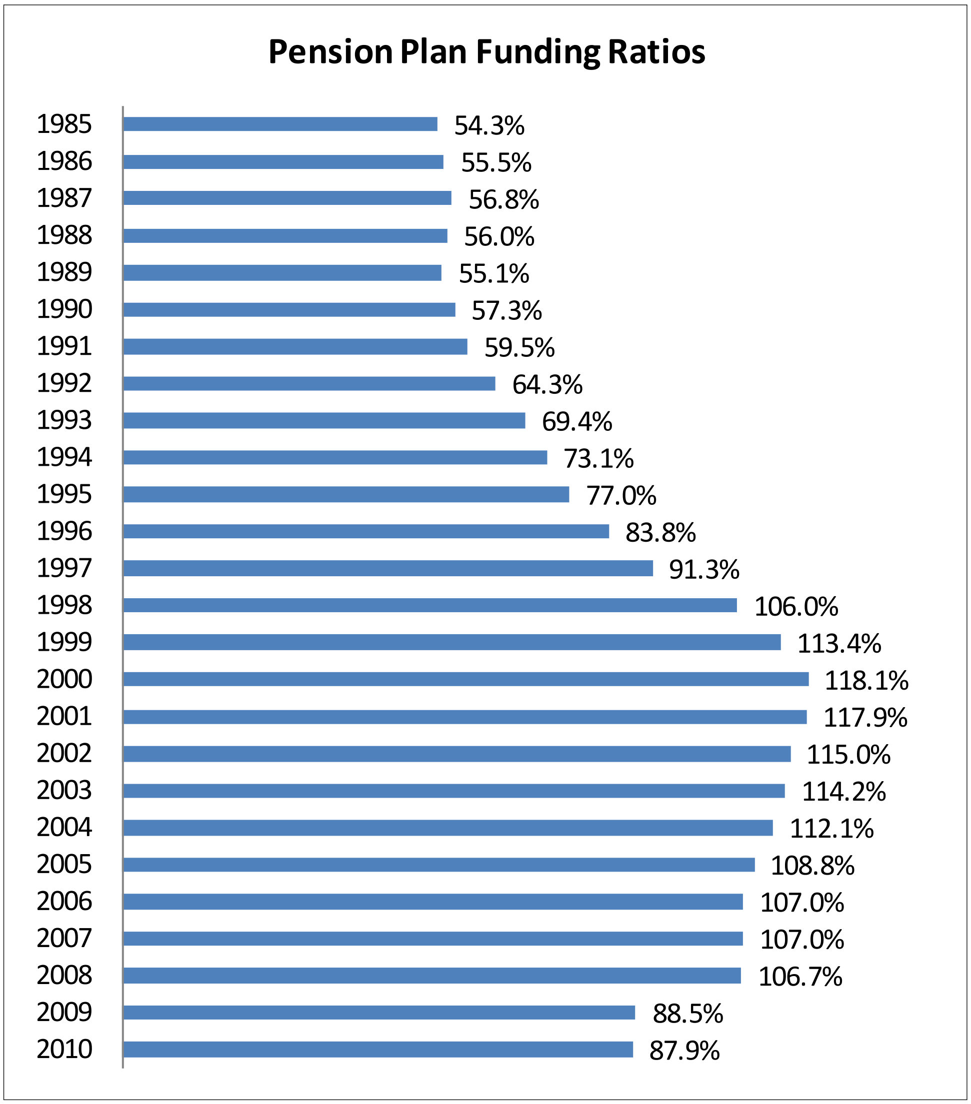
Source: State Board of Administration.

Appendix B

Pension Plan Historical Funding

From 1998 to 2008, the Pension Plan had a funding surplus. However, the plan's funding ratio has been declining since 2000.

Table B
Pension Plan Funding Status Has Markedly Declined in the Last Two Years



Source: State Board of Administration.

Appendix C

Allocation of Pension Fund Assets Varies Among States

Asset allocation is the distribution of a pension plan's assets among various investment classes such as equities, fixed income, real estate, and cash. Studies show that asset allocation is the primary determinant of the plan's long-term investment performance. Relatively minor differences in asset allocation can have significant effects on a fund's investment performance. As shown below, the allocation of assets to various investment classes varied among states.

Table C
States Vary in Their Asset Allocation

State[1]	Equities	Fixed Income	Real Estate	Alternative Investments	Cash Equivalents	Other
Alabama	59%	27%	9%	3%	2%	0%
Alaska	52%	15%	0	32%	1%	0%
Arizona	65%	26%	3%	2%	4%	0%
Arkansas	63%	24%	0%	13%	0%	0%
California	44%	28%	7%	14%	7%	0%
Colorado	59%	22%	6%	10%	1%	2%
Connecticut	56%	33%	4%	8%	0%	0%
Delaware	48%	22%	0%	23%	7%	0%
Florida	**56%**	**29%**	**8%**	**7%**	**1%**	**0%**
Illinois	47%	16%	10%	5%	3%	19%
Indiana	51%	32%	0%	17%	1%	0%
Iowa	35%	41%	8%	12%	5%	0%
Kentucky	52%	25%	0%	10%	3%	10%
Louisiana	50%	24%	0%	25%	1%	0%
Maine	60%	29%	4%	7%	0%	0%
Massachusetts	55%	22%	6%	14%	1%	3%
Michigan	49%	19%	9%	19%	3%	2%
Minnesota	61%	22%	0%	15%	2%	0%
Mississippi	69%	26%	4%	0%	1%	0%
Missouri	47%	12%	0%	30%	0%	11%
Montana	64%	30%	5%	0%	1%	0%
Nevada	56%	34%	0%	8%	2%	0%
New Hampshire	59%	32%	6%	2%	0%	0%
New Jersey	49%	30%	2%	12%	7%	0%
New Mexico	70%	16%	0%	14%	0%	0%
New York	55%	26%	7%	10%	0%	2%
North Carolina	89%	0%	5%	4%	0%	1%
North Dakota	45%	44%	6%	5%	1%	0%
Ohio	63%	24%	6%	4%	3%	0%
Oklahoma	62%	38%	0%	0%	0%	0%
Oregon	37%	30%	10%	19%	3%	0%
Pennsylvania	47%	15%	8%	23%	0%	7%
Rhode Island	58%	24%	0%	14%	5%	0%
South Carolina	11%	33%	0%	42%	15%	0%
South Dakota	53%	24%	9%	14%	0%	0%
Tennessee	40%	49%	5%	0%	6%	0%
Texas	62%	35%	0%	3%	0%	0%
Utah	37%	24%	15%	20%	4%	0%
Vermont	56%	22%	5%	17%	0%	0%
Virginia	41%	31%	9%	8%	1%	10%
Washington	36%	23%	18%	23%	0%	0%
West Virginia	50%	20%	10%	10%	0%	10%
Wisconsin	56%	30%	5%	6%	1%	2%

[1] Seven states were excluded from this analysis. Idaho, Nebraska, and Wyoming were excluded from this analysis because they reported only their target asset allocation and not their actual allocation. Georgia was excluded because it did not report its allocation in a manner similar to other states. Kansas and Maryland were excluded because they did not report the value of assets in each asset class. Hawaii was excluded because it had not published its Fiscal Year 2008-09 annual report by the completion of our fieldwork.

Source: State's investment performance reports for Fiscal Year 2008-09.

Appendix D

STATE BOARD OF ADMINISTRATION OF FLORIDA

1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

February 22, 2011

Ms. Kathy McGuire
Interim Director
Office of Program Policy Analysis and
Government Accountability
Room 312, Claude Pepper Building
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Ms. McGuire:

We reviewed the Office of Program Policy Analysis and Government Accountability's (OPPAGA) preliminary findings and recommendations contained in the report titled: *Compared to Other States, the Pension Plan is Better Funded, Incurs Lower Investment Fees, and Has Fewer Trustees; Investment Returns are Average.*

With respect to the analysis contained in the report, we appreciate the considerable time and effort OPPAGA invested in gathering individual state pension system's performance data. Further we commend OPPAGA for recognizing that:

> *Asset allocation, the distribution of a pension plan's assets among various investment classes such as equities, fixed income, real estate, and cash, is the primary determinant of the plan's long-term investment performance. Relatively minor differences in asset allocation can significantly affect a fund's investment performance over the long-term.* (Page 5)

We believe that the FRS Pension Plan's higher allocation to stocks and lower allocation to alternative investments than peers during the extreme stock market declines experienced in 2001/02 and 2008/09 are the primary reasons for the "average" performance over the last 10 years. As shown in the attached Table 1, over longer periods, the FRS Pension Plan's performance, gross of fees, has generally met or exceeded defined benefit peer returns and various benchmarks. Additionally, the FRS Pension Plan's low cost structure relative to other pension plans creates above average net investment returns; which accrue directly to the benefit of participating employers and taxpayers.

Ms. Kathy McGuire
February 22, 2011
Page 2

With respect to the recommendation presented in the report, the SBA will work with the Department of Management Services, Division of Retirement to develop a single, comprehensive annual report that would provide information specified in the Government Finance Officers' Association's guidelines.

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

Sincerely,

Ashbel C. Williams
Executive Director & CIO

Table 1: FRS Pension Plan versus Defined Benefit Peers and Various Performance Benchmarks
Annualized Gross of Fees Performance for Periods Ending December 31, 2010

	1 Year	3 Years	5 Years	10 Years	15 Years	20 Years	25 Years	30 Years
FRS Pension Plan	13.78%	0.36%	4.85%	4.77%	7.61%	9.15%	9.30%	10.35%
TUCS Median (1)	13.39%	0.67%	4.56%	4.82%	7.37%	8.88%	9.30%	NM
FRS Pension Plan Market Benchmark (2)	12.89%	-0.08%	4.44%	4.32%	7.24%	8.92%	9.47%	NA
FRS Pension Plan Absolute Target (3)	6.57%	6.50%	7.00%	6.87%	6.90%	6.97%	7.30%	7.64%
FRS Pension Plan Actuarial Return Assumption (4)	7.75%	7.75%	7.75%	7.84%	7.89%	7.92%	7.98%	8.10%

(1) TUCS Median is taken from the Wilshire Trust Universe Comparison Service All Defined Benefit Plans (corporate and public). There are only 11 plans reporting 30 years return histories and the data is deemed not meaningful (NM).

(2) FRS Pension Plan Market Benchmark is defined in the Investment Policy Statement as a weighted average of each asset class benchmark where the weights are the policy allocations for each asset class. The Benchmark data begins in 1985 so the 30 years return history is not available (NA).

(3) FRS Pension Plan Absolute Target is the actual rate of inflation added to the Absolute Real Target Rate of Return. The Absolute Real Target Rate of Return is the total rate of return by which the Pension Plan must grow, in excess of inflation, in order to achieve the long-run investment objective.

(4) FRS Pension Plan Actuarial Return Assumption is independently developed by the plan actuary (under contract to the Department of Management Services). The assumption is used, in part, to establish annual actuarial valuations of the FRS Pension Plan. The Actuarial Return Assumption is periodically changed and is currently 7.75%.

State of Florida
DEPARTMENT OF MANAGEMENT
Services

Governor Rick Scott

Office of the Secretary
4050 Esplanade Way
Tallahassee, Florida 32399-0950
Tel: 850.488.2786
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February 10, 2011

Ms. Kathy McGuire, Interim Director
Office of Program Policy Analysis and
Government Accountability
Claude Pepper Building Room 312
111 West Madison Street
Tallahassee, FL 32399-1450

Dear Ms. McGuire:

Pursuant to Section 11.51(5), Florida Statutes, this is our response to your report, ***Compared to Other States, the Pension Plan Is Better Funded, Incurs Lower Investment Fees, and Has Fewer Trustees; Investment Returns Are Average***. Our response corresponds with the order of the preliminary and tentative findings and recommendations contained in the draft report.

If further information is needed concerning our response, please contact Steve Rumph, Inspector General, at 488-5285.

Sincerely,

John P. Miles
Secretary

Attachment

cc: David Faulkenberry, Deputy Secretary
Sarabeth Snuggs, Director of Retirement

We serve those who serve Florida.

Ms. Kathy McGuire
February 10, 2011
Page 2

Department of Management Services' Response
To the OPPAGA's Preliminary and Tentative Report
Compared to Other States, the Pension Plan Is Better Funded, Incurs Lower Investment Fees, and Has Fewer Trustees, Investment Returns Are Average

Finding No. 1:

Florida does not currently provide the information recommended by the Government Finance Officers' Association in a single comprehensive report.

Recommendation No. 1:

We recommend that the SBA work with the Division of Retirement to develop a single, comprehensive annual report that would provide information specified in the Government Finance Officers' Association's guidelines.

Response No. 1:

Section 121.135, Florida Statutes requires the Department of Management Services (DMS) to provide an annual report to the Legislature on the operation and condition of all state administered retirement systems. The Florida Retirement System Pension Plan is one of several plans that DMS includes in the annual report.

The State Board of Administration (SBA) is required by section 214.44(5), Florida Statutes, to provide on or before January 1 of each year an investment report to the Legislature. This report includes specific items as delineated in the statutes on each fund entrusted to the SBA for investment. The Florida Retirement System Pension Plan is one of the many funds managed by the SBA and included in the report.

Should the Legislature determine that a single report developed with information from both DMS and the SBA is more desirable, DMS will implement the recommendation as directed by the Legislature.