



Office of Program Policy Analysis And Government Accountability



John W. Turcotte, Director

March 1998

Review of the 1997 Actuarial Valuation of the Florida Retirement System

Abstract

- **The Florida Retirement System's (FRS) 1997 actuarial valuation recommended reasonable contribution rates. (Page 2, column 2.)**
- **The valuation was made in accordance with relevant laws, rules, and actuarial standards. (Page 2, column 2.)**
- **Our consulting actuary noted several concerns regarding the 1997 valuation: it used a salary increase rate assumption that differs from the type used by most large pension systems and it did not provide detailed information needed to assess the effect of some factors on system liabilities. (Page 3, column 1.)**
- **Significant progress has been made in improving the system's funding status. (Page 3, column 1.)**

Purpose

The Office of Program Policy Analysis and Government Accountability (OPPAGA) conducted this review as required by s. 112.658, F.S. The review's objectives were to determine: whether the Florida Retirement System (FRS) 1997 actuarial valuation's results were

reasonable; whether progress has been made in improving the system's funding status (the ability of system assets to pay future benefits when due); and whether the department's consulting actuary made the valuation using generally accepted and statutorily required standards, methods, and procedures. To complete this review, we contracted with Buck Consultants to serve as our actuarial consultant.

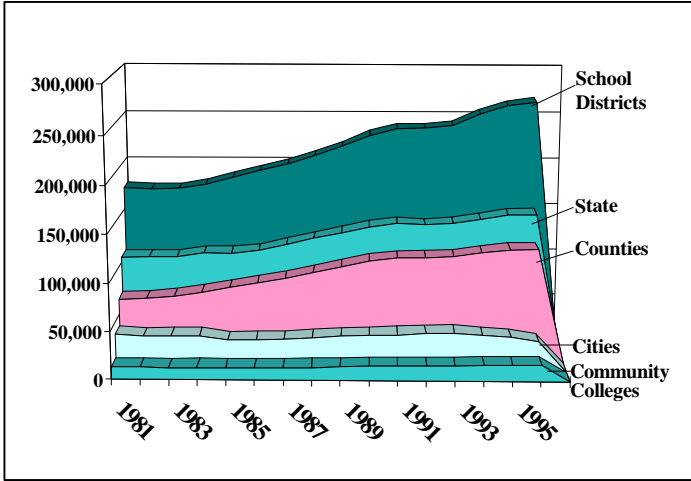
Background

Section 121.031(3), F.S., requires the Division of Retirement to cause an actuarial valuation of the Florida Retirement System to be made at least every two years with the results reported to the Legislature by February 1 prior to the next legislative session.

Actuarial valuations of the system are made in order to determine the contribution rates needed to cover the system's normal costs (the percentage of salary needed to be contributed each year to cover the cost of future benefit obligations); to determine the contribution rates needed to amortize the system's unfunded actuarial liability (the amount of pension liabilities not covered by contributions made at the normal cost rate or by investment of plan assets); and to assess the system's funding status.

The Florida Retirement System provides pension benefits to state employees and employees of local school districts, counties, certain cities, and community colleges. School district employees comprise the largest FRS membership group, followed by state and county employees. (See Exhibit 1.)

Exhibit 1
School District Employees Comprise the System's Largest Membership Group



Source: Division of Retirement documents

Over the past 15 years, the system has experienced significant membership growth. During Fiscal Years 1980-81 through 1996-97, the number of members increased from 393,894 to 589,765 (approximately 50%). (This was mostly due to growth in school district employment.) During this same period, the number of system annuitants (retirees or their beneficiaries receiving retirement payments) from 59,533 to 157,211 (approximately 164%). (See Exhibit 2.)

The Florida Retirement System is administered by the Division of Retirement. Pension benefits and all

Division of Retirement operating expenses are paid from revenues deposited in the Florida Retirement System Trust Fund. Trust Fund revenues for Fiscal Year 1996-97 totaled \$14.651 billion, with \$11.563 billion in net investment-related income and \$3.089 billion from contributions made by state and local government units. System expenditures in Fiscal Year 1996-97 totaled approximately \$1.591 billion, with \$1.575 billion in benefit payments to annuitants.

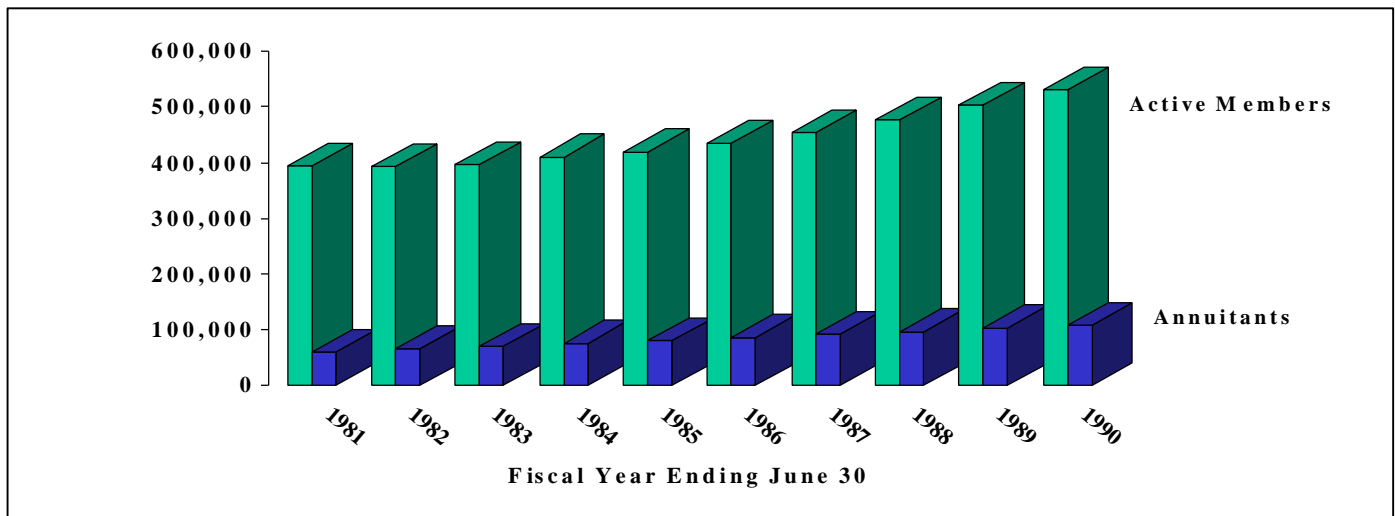
Florida Retirement System Trust Fund assets are administered by the State Board of Administration. As of June 30, 1996, the market value of Trust Fund assets was \$67.4 billion.

Findings

Our consulting actuary concluded the 1997 actuarial valuation recommended contribution rates that were calculated in accordance with relevant state laws and rules. However, the actuary noted several concerns regarding the valuation's assumptions and methods.

Our consulting actuary, Buck Consultants, concluded that the 1997 actuarial valuation recommended contribution rates for covering the Florida Retirement System's normal costs and amortizing its unfunded actuarial liability that were calculated in accordance with relevant state laws and rules.

Exhibit 2
FRS Active Members and Annuitants Have Increased



Source: Division of Retirement documents

The system's 1997 actuarial valuation provides recommended contribution rates for funding its normal costs and amortizing its unfunded actuarial liability. For example, the normal cost contribution rate for regular members would be 10.64% while the contribution rate for amortizing the unfunded actuarial liability would be 4.87%. The resulting total contribution rate (15.51) is 2.15% lower than the rate recommended in the 1995 actuarial valuation.

However, based on its experience with other pension systems, Buck Consultants noted several concerns regarding the assumptions and methods used by the division's consulting actuary.

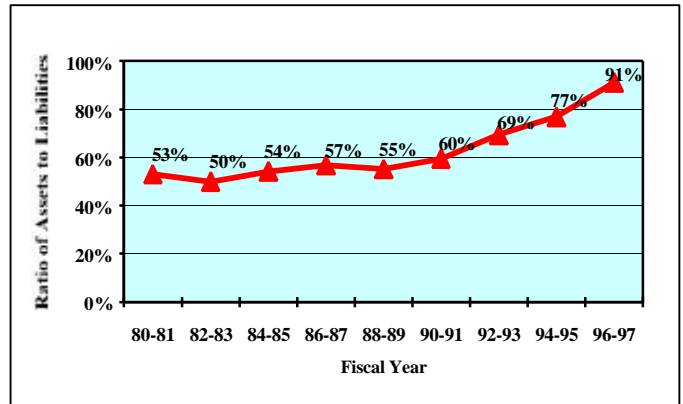
- The valuation did not provide detailed information needed to assess the impact of certain factors, on system liabilities. For example, the valuation did not provide data comparing the number of persons expected to leave the system to actual figures. Such information is needed to assess the assumption's reasonableness.
- The type of salary increase rate assumption used in the 1997 actuarial valuation differs from the type used by most large pension systems. The 1997 actuarial valuation assumed that salaries for all system members would increase at a flat rate of 7.25% per year. However, Buck Consultants indicated that most large pension systems typically use a salary increase rate assumption that is graded by member age or years of service. This type of assumption recognizes that salary increases are usually higher for employees early in their careers than for employees toward the end of their careers. Since the effect of salary increases on pension costs is more significant for older members, the use of a graded salary increase assumption would result in lower contribution rates than the current assumption.

Significant progress has been made in improving the Florida Retirement System's funding status.

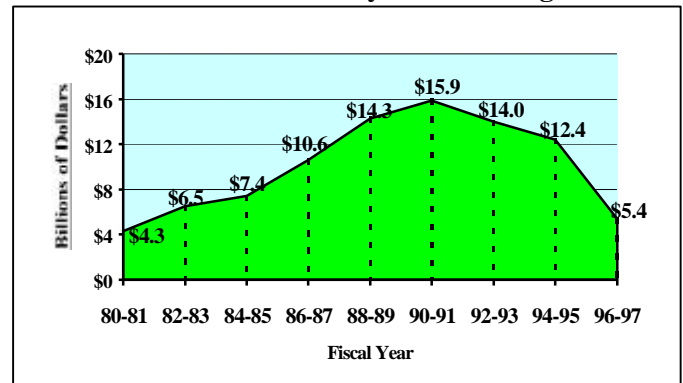
Actuarial valuations provide a means to assess whether a pension system is making progress in improving its funding status. One measure of a system's funding status is the sufficiency of its assets in covering benefit liabilities. As shown in Exhibit 3, the system's ratio of assets to liabilities significantly increased from Fiscal Year 1992-93 to 1996-97 (69% to 91%), continuing a positive trend that began in 1991. Further, the system's unfunded actuarial liability decreased from

approximately \$12.45 billion as of June 30, 1995, to \$5.4 billion as of June 30, 1997, primarily as a result of positive investment experience and member salary increases being lower than expected. (See Exhibit 4.)

**Exhibit 3
Funding Status Is Improving**



**Exhibit 4
Unfunded Liability Is Decreasing**



Source: Division of Retirement documents

Observations

Based on our review, we offer the following observations:

- Significant progress has been made in improving the Florida Retirement System's funding status and reducing its unfunded actuarial liability. This outcome is the result of various factors, including positive investment experience and salary increases being lower than expected.
- Assuming no significant changes are made to the economic assumptions used in future actuarial valuations, the system's present unfunded actuarial liability should be paid off by 2004.

Recommendations

If the Legislature's goals are to maintain a high priority on continuing to improve FRS's funding status and reduce its unfunded actuarial liability, we recommend that the Legislature continue funding the FRS at the levels recommended by the Division of Retirement and its consulting actuary in the 1997 actuarial valuation.

We recommend the Division of Retirement ensure that future actuarial valuations provide more complete information for assessing the impact of various factors on the system's liabilities. We also recommend that the Division consider changing the salary increase assumption from a flat rate to a rate that varies depending on member age and years of service.

Response from the Florida Division of Retirement

March 20, 1998

Mr. John W. Turcotte, Director
Office of Program Policy Analysis and
Government Accountability
Post Office Box 1735
Tallahassee, Florida 32302

Dear Mr. Turcotte:

Pursuant to Section 11.45(7)(d), Florida Statutes, and your March 10 request, my response to the preliminary findings and recommendations of your review of the 1997 Actuarial Valuation of the Florida Retirement System is as follows:

Recommendation: We recommend the Division of Retirement ensure that future actuarial valuations provide more complete information for assessing the impact of various factor's on the system's liabilities.

Corrective Action: Appropriate corrective action will be taken when preparing the next valuation of the FRS.

Recommendation: We also recommend that the Division consider changing the salary increase assumption from a flat rate to a rate that varies depending on member age and years of service.

Corrective Action: A variable salary increase assumption was studied during the 1993 experience study and deemed not necessary. This matter will be taken under advisement during the next experience study of the FRS.

Sincerely,

/s/ A.J. McMullian III
State Retirement Director

AJM:mmc

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Project conducted by: Tom Roth (850/488-1024)