The Florida Senate

Interim Project Report 2007-127 *October 2006*

Committee on Governmental Operations

THE SUPPLEMENTAL RETIREMENT PROGRAM OF THE INSTITUTE OF FOOD AND AGRICULTURAL SCIENCES AT THE UNIVERSITY OF FLORIDA

SUMMARY

The 1984 Legislature created a supplemental pension plan for designated employees of the University of Florida's Institute of Food and Agricultural Sciences. The nature of the plan design and the demographic changes to the IFAS membership make this plan increasingly expensive to the university and more precarious for the maintenance of benefit solvency. The report identifies three policy choices and associated funding options and makes a recommendation for a durable solution to the funding imbalance.

BACKGROUND

The 1984 Legislature enacted s. 121.40, F.S., a supplemental retirement plan for cooperative extension service employees at the University of Florida's Institute of Food and Agricultural Sciences.[1] An eligible employee must have been retired from the federal civil service and not otherwise eligible for Social Security benefits. The supplemental plan provided an equalized Florida Retirement System (FRS) income benefit payable upon retirement from IFAS.

Various portions of the FRS membership were once exempted from coverage of the Social Security Act. Even before creation of the FRS in 1970 two of its predecessor plans were partitioned into separate divisions with new members only provided Social Security Act coverage. Several "open enrollment" periods permitted participants in the existing systems to transfer membership to the new FRS. Many took advantage of the transfer provisions but there are a handful of active and retired members remaining in these prior systems.[2]

IFAS employees retired from the federal civil service and ineligible for social security benefits employed prior to July 1, 1983 who have federal and state appointments would receive a full benefit upon retirement equivalent to the difference between their federal benefit and an FRS benefit, inclusive of social security. The participant was required to satisfy six specific criteria, the effect of which made the IFAS supplemental plan a "closed system." As new hires qualified for FRS and social security benefits, they would be excluded from the supplement. With a fixed census the attrition to retirement would serve to deplete the active membership ranks over the succeeding years. Unfortunately, as the membership declined so, too, did employer payroll contributions, thus creating a greater draw on benefits by retirees than could be replaced by investment earnings or contributions from new participants. The IFAS plan, like the legacy Pension Plan of the FRS is a defined benefit, or percent-of-final-pay plan in which the final annuitized benefit is a function of years of service, average salary, and a stated accrual value for each service year. For IFAS the accrual, 1.6%, is the same as that for the Regular Class of the FRS. Defined benefit plans place the burden of funding responsibility upon the sponsor. Since the FRS has been a non-participatory plan since 1975 - employees do not make matching payroll contributions - that burden falls directly upon IFAS.

The significance of this matter assumes greater legal dimensions because of two additional factors. *First,* ss. 13 of s. 121.40, F.S., requires the investment of IFAS funds in the least volatile securities " . . .directed toward developing minimum-risk procedures for supporting a prescribed liability schedule." This

[1] Chapter 84-358, *Laws of Florida*.

[2] The predecessor plans were the Teachers' Retirement System; State and County Officers and Employees' Retirement System; the Highway Patrol Pension Fund; and the Judicial Retirement System.

effectively "immunizes" the investment portfolio against the risk of loss but it also limits its ability to realize gains. The underlying investments are not diversified and are simply unable to satisfy the benefit demands. Unlike the FRS in which there three active employees for each annuitant, in IFAS there are only 190 members, 109 of which are annuitants.[3] *Second*, since 1976 the State Constitution has required the prefunding of all public sector pension benefits to specifically avoid the intergenerational transfer of unfunded risk.[4] Plan sponsors in Florida cannot avoid the financial recognition of benefit promises. High quality but low yielding investments such as those that characterize the IFAS plan cannot sustain the benefit demands without additional funding. The effect of using non-recurring revenues to supplement this financial imbalance can bring additional legal jeopardy to this plan as it may no longer adhere to the constitutional requirement that it " . . . concurrently make(s) provision for the funding of the increase in benefits on a sound actuarial basis."

METHODOLOGY

The interim report reviews actuarial material developed by the Division of Retirement, its consulting external actuary, and cumulative history of the IFAS statute. This report updates one previously published in 2005.[5]

FINDINGS

Until a few years ago small, biennial increases to the employer contribution rate moderated this known but deferred IFAS funding imbalance. Beginning in 2002, however, the employer funding increased dramatically from 7.17% to 13.83% of payroll. The 2004 biennial valuation of IFAS suggested an increase in this amount to 20.23% would be required to support the IFAS plan. The 2006 Legislature chose to freeze the contribution at 13.83% but provided a lump sum of $300,000 - $500,000 in the prior fiscal year - to IFAS to actuarially offset the payroll effects.[6] This budget action however provides relief for only a limited period.

The Division of Retirement itself commissioned an actuarial analysis of the IFAS plan to determine alternative financial options. Its consulting actuary reported that a possible option could include transfer of IFAS plan assets and liabilities to the FRS. Active and retired members and beneficiaries would not notice a change as their benefits would not be compromised. Due to the small asset and liability base of IFAS, its incorporation within the FRS would condition only a small adverse dollar impact. The FRS has more than $112 billion in assets and includes a $10 billion actuarial surplus. Under this option, no additional payroll costs would be passed along to its nearly 900 member employers.

RECOMMENDATIONS

The report describes the history of the IFAS supplement plan and describes three methods for addressing its recurring funding imbalance:

(1) status quo with significantly higher biennial increases to the contribution rate;
(2) a capped rate with supplemental annual appropriations; or
(3) merger of the IFAS plan within the FRS.

Because the active and inactive membership base is small and the IFAS plan is a closed system, this report recommends merger of IFAS, and its assets and liabilities, into the FRS and the assumption of benefit payments within this larger and better funded pension plan. Unlike the two other options that provide only annual or biennial relief, this alternative will permanently address the IFAS funding imbalance. After such transfer, the employer payroll costs will decline significantly and reflect the rates charged for the Regular Class in the FRS.[7]

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[3] As of June 30, 2005.
[4] Section 14, Article X, *State Constitution*. See also Part VII (Actuarial Soundness of Retirement Systems) of Chapter 112, *Florida Statutes*.
[5] *The Supplemental Retirement Program of the Institute of Food and Agricultural Sciences at the University of Florida*, Interim Project Report 2006-135, September 2005.
[6] Section 8, General Appropriations Act for Fiscal Year 2005-2006, Chapter 2005-152, *Laws of Florida*.
[7] For the Fiscal 2006 plan year the Regular Class rate is 6.67% compared with the IFAS rate of 13.83%.