#405

Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER)

Report to
the Mississippi Legislature

A Review of the Mississippi Government Employees' Deferred Compensation Plan and Trust

The Mississippi Government Employees' Deferred Compensation Plan is a supplemental savings plan administered by the Public Employees' Retirement System (PERS) Board of Trustees. Participants in the Deferred Compensation Plan may elect to invest in any of ten funds. The PERS Board is responsible for fund selection and contracts for administrative, marketing, and recordkeeping services. A participant's current income taxes are reduced because the participant defers part of his or her salary and does not pay federal and state income taxes on those contributions until withdrawal of the funds. Interest and savings on contributions are also tax deferred until withdrawal.

PERS has administered the plan in compliance with applicable state and federal laws and the level of administrative services and the fees charged by the contractor are appropriate and customary for the industry. However, the plan's offering of investment funds contains several funds of the same or similar asset classification. The offering lacks a small capitalization domestic equity fund for the more aggressive investor and should add several asset allocation funds for the less sophisticated investor.

May 10, 2000

PEER: The Mississippi Legislature's Oversight Agency

The Mississippi Legislature created the Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER Committee) by statute in 1973. A standing joint committee, the PEER Committee is composed of five members of the House of Representatives appointed by the Speaker and five members of the Senate appointed by the Lieutenant Governor. Appointments are made for four-year terms with one Senator and one Representative appointed from each of the U. S. Congressional Districts. Committee officers are elected by the membership with officers alternating annually between the two houses. All Committee actions by statute require a majority vote of three Representatives and three Senators voting in the affirmative.

Mississippi's constitution gives the Legislature broad power to conduct examinations and investigations. PEER is authorized by law to review any public entity, including contractors supported in whole or in part by public funds, and to address any issues, which may require legislative action. PEER has statutory access to all state and local records and has subpoena power to compel testimony or the production of documents.

PEER provides a variety of services to the Legislature, including program evaluations, economy and efficiency reviews, financial audits, limited scope evaluations, fiscal notes, special investigations, briefings to individual legislators, testimony, and other governmental research and assistance. The Committee identifies inefficiency or ineffectiveness or a failure to accomplish legislative objectives, and makes recommendations for redefinition, redirection, redistribution and/or restructuring of Mississippi government. As directed by and subject to the prior approval of the PEER Committee, the Committee's professional staff executes audit and evaluation projects obtaining information and developing options for consideration by the Committee. The PEER Committee releases reports to the Legislature, Governor, Lieutenant Governor, and the agency examined.

The Committee assigns top priority to written requests from individual legislators and legislative committees. The Committee also considers PEER staff proposals and written requests from state officials and others.

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The Mississippi Legislature

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May 10, 2000

Honorable Ronnie Musgrove, Governor
Honorable Amy Tuck, Lieutenant Governor
Honorable Tim Ford, Speaker of the House
Members of the Mississippi State Legislature

On May 10, 2000, the PEER Committee authorized release of the report entitled **A Review of the Mississippi Government Employees' Deferred Compensation Plan and Trust.**

William Canon

Senator William Canon, Chairman

This report does not recommend increased funding or additional staff.

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December 21, 1999

PEER Committee
P. O. Box 1204
Jackson, MS 39215-1204

Re: Review of Mississippi Government Employees' Deferred Compensation Plan and Trust

Gentlemen:

Enclosed is our review of the Mississippi Government Employees' Deferred Compensation Plan and Trust as outlined in the Contract for Professional Services which was executed with the PEER Committee on October 29, 1999.

Our findings are as follows:

- In general the Plan complies with applicable state and federal laws. However, there are drafting errors and omissions in the Plan document. In addition, greater care should be taken in communicating annual limits on the amount of employee contributions to the Plan.
- The level of administrative services and fees charged are appropriate and customary for the industry.
- The offering of ten investment funds contains several redundant funds of the same or similar asset classification. The offering lacks a small capitalization domestic equity fund for the more aggressive investor and should add several asset allocation funds for the less sophisticated investor.

We wish to acknowledge the cooperation and support we received from the PERS staff. All of our requests for information were provided in a timely and complete manner. We appreciate the opportunity of providing these services to the Joint Committee on Performance Evaluation and Expenditure Review and will be pleased to supplement this report in any way.

Sincerely,

Mike Brister

Mike Brister, F.S.A.
Consulting Actuary

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Executive Summary

Background

MISS. CODE ANN. Section 25-11-101 authorizes the PEER Committee to "have performed random actuarial evaluations, as necessary, of the funds and expenses of the Public Employees' Retirement System and to make annual reports to the Legislature on the financial soundness of the system."

Deferred Compensation is a supplemental savings plan administered by the Public Employees' Retirement System (PERS) Board of Trustees. Any employee, elected official, or independent contractor of the State of Mississippi or one of its political subdivisions is eligible to participate in Deferred Compensation. A participant's current income taxes are reduced because the participant defers part of his or her salary and does not pay federal and state income taxes on those contributions until withdrawal of the funds. Interest and savings on the contributions are also tax deferred until withdrawal.

Participants in the Deferred Compensation Plan may elect to invest in any of ten funds. The PERS Board is responsible for fund selection and has contracted with Systematized Benefits Administrators, Inc., to provide administrative, marketing, and recordkeeping services.

The PEER Committee contracted with Bryan, Pendleton, Swats and McAllister, Actuaries and Consultants, to review the Mississippi Government Employees' Deferred Compensation Plan and Trust. Bryan, Pendleton made the following conclusions.

PERS Has Administered the Deferred Compensation Plan in Compliance with Applicable State and Federal Laws

Although PERS has administered the plan in accordance with state and federal laws, drafting errors and omissions in the plan document should be addressed. Also, PERS should take more care in communicating the salary deferral limitations to employees, since these limitations take into account amounts deferred under other plans to which state employees may have access.

The Level of Administrative Services and the Fees Charged by the Contractor are Appropriate and Customary for the Industry

Major enhancements in plan administration over the last several years include:

- Funds and participant accounts are valued on a daily basis, which allows employees to move money between funds with little restrictions as to timing.
- Participants may use a toll-free telephone number to check account values, change allocation of contributions, and move money among funds.
- Participants may access their accounts through a website.

The Plan's Investment Fund Offering Contains Redundancy of Some Types of Funds and Lacks Other Types of Funds

The plan's offering of ten investment funds contains several funds of the same or similar asset classification. The offering lacks a small capitalization domestic equity fund for the more aggressive investor and should add several asset allocation funds for the less sophisticated investor.

For More Information or Clarification, Contact:

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Introduction

The Mississippi Government Employees' Deferred Compensation Plan and Trust allows employees to defer compensation until a later date. The deferral allows them to defer current income tax on the compensation and any investment earnings which may arise from the investment of the deferred compensation. Internal Revenue Code Section 457 governs how plans such as these must operate in order for the deferred income to avoid current taxation.

Employees make executed elections to defer compensation. This deferred compensation is then invested on the employees' behalf. Employees receive periodic updates on their invested funds. Employees choose among various investment options and may transfer money among the different investment funds. In general the Plan has three distinctive components as follows:

1 The legal requirements which allow employees to defer compensation and allow the employer to not withhold income tax on deferred amounts.

2 The service provider which maintains the record of each employee's account, including investment earnings. In addition, the service provider plays a role in educating and enrolling employees.

3. The investment of employee deferrals which allows employees to receive tax deferred investment earnings. Unlike the Public Employees Retirement System of Mississippi (PERS), the employees bear the full investment risk in the Deferred Compensation Plan.

Our review of the Plan will consist of the following:

- Is the Plan being operated in compliance with state laws and Internal Revenue Code requirements?
- Are the level of administrative services and fees charged appropriate and customary for the industry?
- Are the investments of a sufficient number, of a suitable range and are investment results favorable for participants?

Compliance

The Mississippi Government Employees' Deferred Compensation Plan and Trust is maintained pursuant to Mississippi Code Annotated, Sections 25-14-1 and to Internal Revenue Code Section 457.

The Plan is a nonqualified deferred compensation plan. It is "nonqualified" because it is not qualified under Internal Revenue Code Section 401(a). On the other hand, PERS is a "qualified" plan under Code Section 401(a). Section 457 governs the operation of nonqualified deferred compensation plans for governmental employers.

Taxation may be deferred by either of two methods. The employer may maintain an "eligible 457 plan" or an "ineligible 457 plan". In an eligible 457 plan, the deferred compensation will be taxed when it is paid or made available to the participant. In an ineligible 457 plan, the deferred compensation is taxed when the benefit under the plan ceases to be subject to a substantial risk of forfeiture.

To maintain an eligible 457 plan the employer must maintain the plain in compliance with certain requirements under Code Section 457. An eligible 457 plan which is maintained by a governmental unit is given a grace period to make corrections if it ceases to operate in compliance with the eligible 457 plan requirements.

A brief summary of the basic rules are as follows:

1. Only individuals who perform services for an eligible employer may participate.

2. The plan must limit the amount that may be deferred by a participant in one taxable year to the lesser of $7,500 or 33-1/3% of the participant's includible compensation. Includible compensation is the participant's compensation **after** it has been reduced for his deferral to the 457 plan. The $7,500 dollar limit is indexed and is now $8,000 for the 2000 calendar year.

3. The plan may allow for a participant to "catch-up" the amount of his deferrals during the last three taxable years before normal retirement age. In "catch-up" years, the maximum deferral limit for the year is the lesser of $15,000 or the sum of the regular deferral limit for the year plus the amount of the regular deferral limits which have not been used in prior years.

4. Deferrals of compensation may be made under the plan only if the participant enters into an agreement for such deferrals before the first day of the month to which the agreement applies.

5. The plan must provide that distributions from the plan will be made in accordance with each of the following requirements:

   a. Benefits will not be made available before the earlier of attainment of age 70-1/2, separation of service or upon the occurrence of an unforeseen emergency.

   b. Benefits will be distributed in accordance with Code Section 401(a)(9), as follows:

      i. Distributions must begin by the later of attainment of age 70-1/2 or separation from service.

      ii. Distributions must be made over the life expectancy of the participant or the joint lives of the participant and his designated beneficiary.

      iii. If distributions begin before the participant's death, the distributions of any amounts remaining to be distributed must occur at least as rapidly as the amounts distributed before death.

      iv. If distributions do not begin before the participant's death, distributions must be completed within five years after his death, unless

         A. it is made for the life of a beneficiary and it begins within one year of the death of the participant, or

         B. it is made to the spouse of the participant.

      v. The form of payment must provide that at least one-half of the benefit be paid to the participant.

6. A plan maintained by a governmental entity must provide that the assets of the plan are held in trust for the exclusive benefit of the participant and their beneficiaries.

In addition to the above rules, there are various other regulations affecting the operation of an eligible 457 plan. Some of the more important of these are as follows:

1. All deferrals under an eligible 457 plan, tax sheltered annuity (403(b) annuity plan), or 401(k) plan count toward the $8,000 (or 33-1/3% of includible compensation) limit above. The limit is not a per plan limit but applies to the individual, regardless of the number of plans in which he is a participant.

2. Transfers from one eligible 457 plan to another are allowed. However, rollovers from an eligible 457 plan to a plan qualified under Code Section 401(a), a tax sheltered annuity or an IRA are not permitted.

3. The participant may make certain elections regarding his deferred compensation which will not jeopardize the deferred tax status of the compensation. These elections include:

   a. an election to defer payment of the benefit until a later date (within limits), if the election is made before the payment is available;

   b. an election of investment options; and

   c. an election to receive small amounts in a lump sum after separation from service.

The Plan is intended to be an "eligible 457 plan." Our review of the Plan document will consider the requirements for an eligible plan described above. We will also consider drafting errors, omissions and inconsistencies among Plan provisions.

General Comments

Effective December 1, 1998 the name of the Plan was changed to the Mississippi Government Employees' Deferred Compensation Plan and Trust. All documents and administrative forms should be changed to incorporate the new name.

Plan Document

Section 2.01 – definition of "Includible Compensation"

The phrase "The amount of Compensation includible in the Participant's federal gross income" is a complete definition of Includible Compensation. The list which follows this phrase is redundant and not complete.

Section 2.03 – definition of "Deferred Compensation"

The parenthetical phrase "(ordinarily the equivalent of 25% of gross income)" is only true if the employee is not making deferrals in other plans that would reduce includible compensation. The phrase is prefaced with "ordinarily", but it would be better if this description were included in communication material instead of the Plan document.

In Section 2.03(b), the $15,000 limit used in catch-up contributions is followed by a parenthetical expression implying the amount is subject to increases by the Secretary of Treasury. There is no statutory provision to allow for adjusting this amount by the Secretary of Treasury.

Section 7.01 – General Benefit Terms

The first part of subsection (a)(ii) lists sections of the Plan that restrict the choice of benefits. Subsection 7.01(g) should be added to the list since it restricts the systematic withdrawal option by requiring at least annual withdrawals of non-increasing amounts.

Subsection (d) has a reference to "7.01 F" that should be modified to be consistent with the rest of the Plan since no Section "7.01 F" exists. We recommend that this reference be replaced with the phrase "the amount otherwise determined under the provisions of the Plan."

Section 7.03 – Benefits Upon Death After Commencement of Benefits

Subsection (a) provides that if the participant dies after benefit payments had started, his beneficiary is allowed to select another payment option. This option should be revised to subject to certain restrictions required under Code Section 457(d)(2)(B). Code section 457(d)(2)(B) requires that if benefit payments were being made to the participant before his death, then any form of distribution elected by the beneficiary generally must pay the benefit at least as rapidly as the form which the participant was receiving.

Participation Agreement

The Plan requires that the annual deferral not be less than $180 per year. We recommend that the Participation Agreement be revised to include the parenthetical "(not less than $180 per year)" after the dollar election blank on the form.

The agreement states that the limit is 25% of "adjusted gross annual salary." It is not clear why the word "adjusted" is in that statement. In addition, as mentioned above, there may be exceptions where the calculation of the limit does not equal 25%. So, we recommend that the word "adjusted" be deleted and that the statement be modified to explain that special rules may further reduce the 25% limit. This explanation could possibly refer to a more detailed explanation or worksheet that could be provided along with the Participation Agreement.

It would also be helpful to provide an explanation of the catch-up election and to add a space to the form where they indicate they are using the catch-up election.

Findings

In general, we believe the Plan is being administered in accordance with state and federal laws. However, there are drafting errors and omissions in the Plan document that should be addressed. In addition, more care should be taken in communicating the salary deferral limitations to employees since these limitations take into account amounts deferred under other plans in which state employees may have access.

Administrative Services

Participants in the Plan may elect to invest in any of ten funds. The Board of Trustees of the Public Employees' Retirement System of Mississippi (PERS) is responsible for the fund selection. The Board has also contracted with Systematized Benefits Administrators, Inc. (SBA) to provide administrative, marketing and recordkeeping services. SBA is a wholly owned subsidiary of Aetna, Inc.

There have been major enhancements in the Plan administration over the last several years as follows:

1. The funds and participant accounts are valued on a daily basis. This affects participant account balances at time of distribution and allows employees to move money between funds with little restrictions as to timing.

2. Participants have a "1-800" phone number they can use to check on account values, to change the allocation of future contributions among investment funds and to move existing money among funds.

3. Through a website on the internet participants may also access their accounts.

Effective July 1, 1999 the annual fee charged by SBA for these services is .25% (25 basis points) of total Plan assets exclusive of life insurance cash values. Our understanding is that this fee is offset by any fund rebates to cover the cost of recordkeeping. PERS is currently in the process of obtaining competitive bids for these administrative services.

Findings

In our opinion, the level of administrative services and fees charged are appropriate and customary for the industry. Since recordkeeping and administrative services are now offered in a very competitive environment, we concur with the decision to seek competitive bids for these services.

Investments

As mentioned above, the Plan offers participants ten investment options. The following shows the Plan's invested assets by fund and fund type as of June 30, 1999.

	June 30, 1999 Market Value (in $1,000)	Percent
Domestic Equity	**$280,414**	**52.3%**
Aetna Growth & Income	136,899	25.5
Fayez Sarofim Fund	122,912	22.9
Barclays Equity Index Fund	15,679	2.9
Boston Co. Premier Value Fund	4,925	.9
International Equity	**25,620**	**4.8**
T. Rowe Price International Fund	25,620	4.8
Balanced	**18,883**	**3.5**
Fidelity Asset Manager	18,883	3.5
Domestic Fixed-Income	**12,634**	**2.4**
Barclays Intermediate Gov't/Corp.	12,634	2.4
Guaranteed Funds	**190,146**	**35.5**
Aetna Fixed Plus Account	173,481	32.4
Nationwide Fixed Account	16,008	3.0
Other	657	.1
Money Market	**8,559**	**1.6**
Barclays Money Market Fund	8,559	1.6

To evaluate the investment options under the Plan, we considered the following:

1. Comparison of investment results with appropriate benchmarks and peer groups;
2. The suitability of investment choices for participants of various ages and risk tolerances;
3. Investment related fees and charges as well as subsidies available to offset recordkeeping fees; and
4. Procedures and policies in place to monitor investment results on an ongoing basis.

Comparison of Investment Results

Information on the individual funds was gathered from the individual fund managers. This information was used to classify each fund into a specific asset class. The classifications were based on the fund's stated objective and characteristics of the fund's assets. For example, domestic equity funds were classified based on the fund's price to earnings (P/E) and price to book (P/B) ratios as well as the median market capitalization of the fund's assets. These were used to determine the fund's style of investing. If the fund's investment style, based on its P/E, P/B and median market capitalization, differed from its stated objective, the fund was evaluated versus its calculated investment style, not its stated objective.

Once classified in an asset class, the funds were compared to common benchmarks as well as to other funds in its specified asset class. Information on peer funds was obtained from the Morningstar database. This is a commonly used database that includes detailed data on 11,000 mutual funds. Individual fund reviews are included in the appendix of this report.

The result of these reviews may be summarized as follows:

Fund	Above Average	Satisfactory	Needs Review
Aetna Growth & Income Fund	☒		
Fayez Sarofim Separate Account			☒
Barclays Equity Index Fund		☒	
Boston Co Daily Premier Value Equity	☒		
T.Rowe Price International Stock Fund			☒
Fidelity Asset Manager		☒	
Barclays Int Gov/Corp Bond Index Fund		☒	
Aetna Fixed Plus		☒	
Nationwide Fixed		☒	
Barclays Money Market Fund		☒	

Suitability of Investment Choices

Three major types of investors can be identified, conservative, moderate, and aggressive. Investment options should be available in the Plan so that each of the three types of investors can build diversified portfolios that meet their risk/return objective. This is based in the thought that participants in employee directed plans such as this should be able to diversify their investment holdings to benefit from the risk reduction/return enhancing characteristics identified in modern portfolio theory.

To ensure employees have access to the necessary types of investments, options should be available in several different asset classes. These asset classes often include, but are not limited to a short-term fixed income fund, a longer-term fixed income fund, a large capitalization domestic equity fund, a small capitalization domestic equity fund, and an international equity fund. The domestic equity funds can be further differentiated on a growth versus value strategy spectrum.

The Plan currently has investment options available in each of these asset classes, and is also somewhat diversified on the value/growth spectrum. Recommendations provided in this document identify additional opportunities to expand diversity of the options or to eliminate redundancy.

There are 3 constraints that determine the optimal number of investment options:

- **Cost -** the number of investment options directly impacts the costs associated with maintaining the plan. Excess funds may increase the plan's recordkeeping, trust and employee communication expenses.

- **Practicality** - research has shown that beyond about 12 funds, participation in defined contribution plans actually decreases. In other words, too many investment options may confuse participants and discourage them from joining the plan. While it is important to offer flexibility to participants, it is also important to provide a simple platform that can be easily understood by participants.

- **Theoretical** - research has proven that asset allocation is the primary determinant of long-term portfolio performance. Therefore, it is more important to determine which asset classes to include in the plan rather than which investment managers to include in the plan. Furthermore, this also implies there is little diversification value to including more than one investment manager for a single asset class.

Evaluation of Investment Fees of the Plan

Evaluation of the total investment fees charged to the Plan is an important aspect of a full Plan review. Reasonable fees are important to participants since fees reduce the return an investor receives in his or her retirement account.

Each of the individual fund fees were reviewed, along with performance, versus peers. Fees should be evaluated versus category averages since different asset classes are more expensive to manage. By comparing fees versus peers, a plan can evaluate a manager based on other similar investments available in the asset class. All fees appear to be below category averages as reported by Morningstar Inc.

Assets of all funds in the Plan are assessed a 25 basis point fee which pays for enrollment, recordkeeping, and administrative services for the Plan. When evaluating fees in this review, all expense reimbursements from funds to recordkeepers were removed. This was done because a manager should not be penalized in a comparison versus peers, which would not be collecting fees that are later reimbursed to the Plan. As a result managers were evaluated on a net fee basis.

Ongoing Evaluation of Investment Options

In regards to the fourth point of evaluation, Callen Associates was hired by the Plan to provide a study to evaluate the investment options in the Plan. Written evaluations of the investment options in the Plan should be completed on a quarterly basis either by qualified internal personnel or by an independent investment advisor. The evaluations should compare the investment performance versus benchmarks and peer groups to ensure that participants are receiving returns that meet reasonable expectations. Overall Plan investment option offerings should be evaluated on an annual basis. This will provide a means of ensuring that the proper investment options are available to the three basic types of investors discussed above.

Findings

1. **Addition of a small capitalization domestic equity fund.** Ideally this would be a small capitalization growth fund which would provide diversification from the mid capitalization value fund included in the Plan. This option would provide a needed investment choice for a more aggressive investor in the Plan.

2. **Elimination of one of the deposit administration (Aetna Fixed Plus or Nationwide Fixed) funds and the Money Market Fund.** Since both deposit administration funds fulfill a similar role in the Plan, including both funds in the Plan causes redundant offerings in the same asset class.

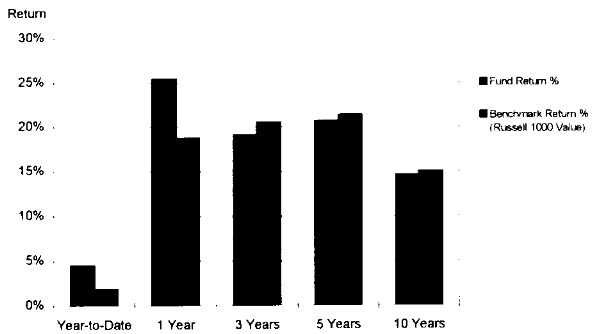
3. **Replace the eliminated Deposit Administration fund and the Money Market fund with a stable value fund with no liquidity restraints**. This fund should have no liquidity restraints like the current Deposit Administration funds have, so that it could be used in a similar way as a money market fund, but provide a higher rate of return on average than the current funds. Examples of this type of fund would be the LaSalle Income Plus Fund, or the Morley Capital Stable Value Fund.

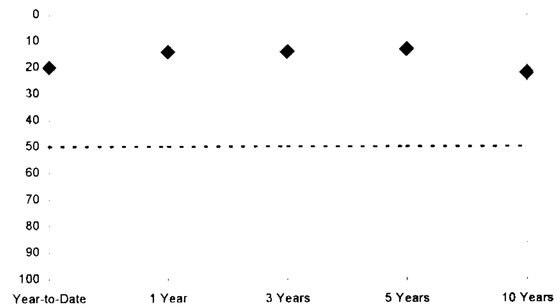
4. **Include Pre-mixed (also called Lifecycle) funds.** There are generally two types of participants in defined contribution retirement plans: 1) those who would like to allocate their assets among multiple mutual funds, and accordingly create their own risk/reward profile, and 2) those who need assistance in determining where to allocate their assets. Pre-mixed funds are designed for investors who need assistance in determining where to allocate their assets. The funds are commonly listed as conservative, moderate, and aggressive. An investor simply chooses one of the three types of funds. Once the selection is made an investor's account is invested in a diversified lineup of funds and in accordance with the risk/return profile that they selected. Pre-mixed funds have become increasingly popular in defined contribution plans.

BENCHMARK – Russell 1000 Value Index

The benchmark chosen for the Aetna Growth & Income Fund is the Russell 1000 Value Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (Russell 1000 Value)	Difference
Year-to-Date	4.45%	1.81%	2.64%
1 Year	25.42%	18.71%	6.71%
3 Years	19.09%	20.51%	-1.42%
5 Years	20.65%	21.39%	-0.74%
10 Years	14.56%	14.95%	-0.39%

Period	Fund Return %	% Rank
Year-to-Date	4.45%	20
1 Year	25.42%	14
3 Years	19.09%	14
5 Years	20.65%	13
10 Years	14.56%	22

COMMENTARY

Fund Management versus Stated Objective – The Fund is being evaluated versus a large capitalization value benchmark and peer group based on its median market capitalization, P/E ratio, and P/B ratio.

Performance versus Benchmark – Recent performance versus the benchmark has been strong, but long-term the Fund underperforms slightly.

Performance versus Peer Group – Performance versus the Fund's peer group has been excellent as the Fund ranks in the top quarter of the group for all time periods.

Fees Comparison – Total fees are 73 basis points after rebates versus 81 basis points for the average institutional priced large capitalization value fund in the Morningstar database.

Additional Comments – Fund seems to be invested in a manner consistent with its stated objective. Despite some slight underperformance versus its benchmark, overall this fund appears to meet or exceed reasonable expectations.

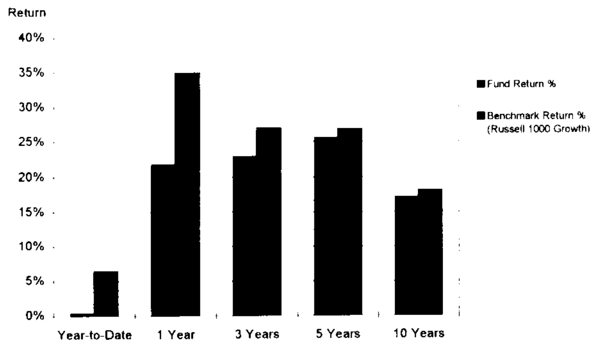
Recommendation – No change would be recommended. This fund appears to be a strong investment option for the large capitalization value asset class.

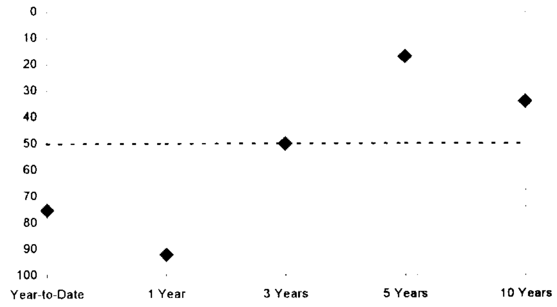
FAYEZ SAROFIM SEPARATE ACCOUNT FUND

BENCHMARK – Russell 1000 Growth Index

The benchmark chosen for the Fayez Sarofim Separate Account Fund is the Russell 1000 Growth Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (Russell 1000 Growth)	Difference
Year-to-Date	0.27%	6.40%	-6.13%
1 Year	21.70%	34.85%	-13.15%
3 Years	22.80%	26.87%	-4.07%
5 Years	25.50%	26.79%	-1.29%
10 Years	17.00%	17.96%	-0.96%

Period	Fund Return %	% Rank
Year-to-Date	0.27%	75
1 Year	21.70%	92
3 Years	22.80%	50
5 Years	25.50%	17
10 Years	17.00%	34

COMMENTARY

Fund Management versus Stated Objective – The Fund's market capitalization and P/B ratio are consistent with a large capitalization growth fund, but its P/E ratio is lower than that of the average large capitalization value fund. The Fund is compared versus a growth benchmark and peer group based on its stated objective and its P/B ratio, but the analysis could produce different results if the Fund is compared with a value benchmark and peer group.

Performance versus Benchmark – The Fund underperformed its benchmark in all time periods. One-year performance has been particularly weak versus the benchmark.

Performance versus Peer Group – Long-term performance of the Fund versus its peer group is strong, but short-term performance has suffered recently. The Fund ranks in the bottom half of its peer group for all time periods three years and shorter.

Fees Comparison – The Fund's expense ratio of 23 basis points is considerably lower than the expense ratio of the average institutional priced large capitalization growth fund in the Morningstar database (90 basis points).

Additional Comments – Further evaluation of the Fund should be made to determine whether or not it is meeting its large capitalization growth objective. Due to the weak short-term performance, the Fund should also be monitored to ensure that long-term performance remains at acceptable levels.

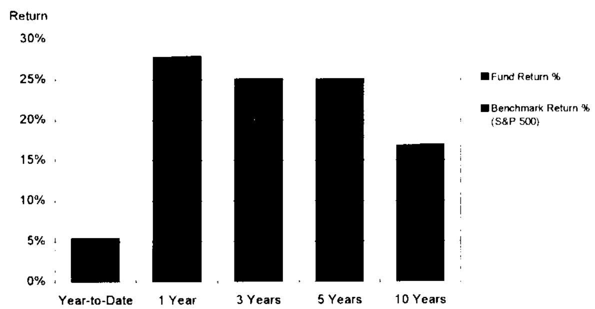
Recommendation – This Fund needs further review.

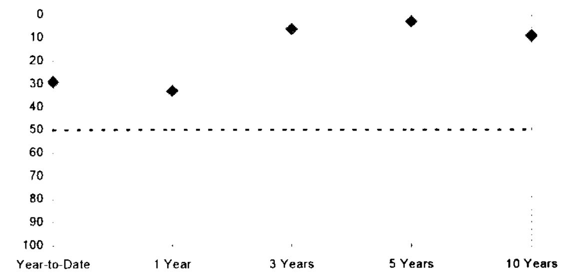
BARCLAYS EQUITY INDEX FUND

BENCHMARK - S&P 500 Index

The benchmark chosen for the Barclays Equity Index Fund is the S&P 500 Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (S&P 500)	Difference
Year-to-Date	5 35%	5 36%	-0 01%
1 Year	27.76%	27.80%	-0.04%
3 Years	25.07%	25.09%	-0.02%
5 Years	25.01%	25.03%	-0.02%
10 Years	16.78%	16.82%	-0.04%

Period	Fund Return %	% Rank
Year-to-Date	5.35%	29
1 Year	27.76%	33
3 Years	25.07%	6
5 Years	25.01%	3
10 Years	16.78%	9

COMMENTARY

Fund Management versus Stated Objective – The Fund is being managed according to its stated objective as it maintains a very high correlation to the S&P 500 Index.

Performance versus Benchmark – The Fund slightly underperformed its benchmark as expected, net of expenses. Before expenses the Fund outperformed the index during several time periods.

Performance versus Peer Group – Due to the recent outperformance of the S&P 500 Index relative to actively managed large capitalization blend funds, the Fund ranked in the top quarter of its peer group for all time periods except one year. This relative performance argues for continued inclusion of this passively managed fund in the large capitalization blend asset class.

Fees Comparison – Due to the Fund being passively managed, expenses are much lower than its peer group. The Fund's expenses are lower than all but one other large capitalization blend fund included in the Morningstar database.

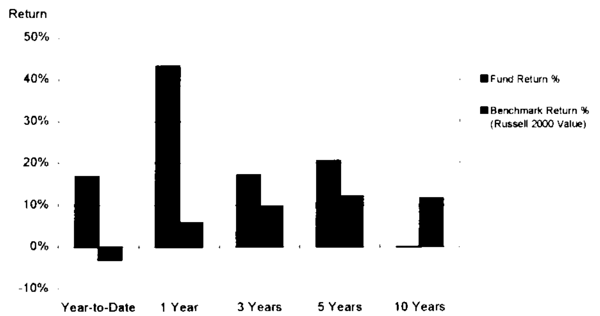
Additional Comments – The Fund appears to be performing exactly as expected, based on its high correlation to the S&P 500 Index and its low expenses.

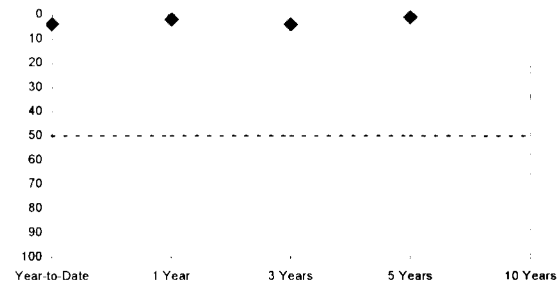
Recommendation – No change is recommended.

BENCHMARK – Russell 2000 Value Index

The benchmark chosen for the Boston Company Premier Value Equity Fund is the Russell 2000 Value Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (Russell 2000 Value)	Difference
Year-to-Date	16.88%	-2.98%	19.86%
1 Year	43.21%	5.82%	37.39%
3 Years	17.14%	9.60%	7.54%
5 Years	20.55%	12.11%	8.44%
10 Years	NA	11.55%	NA

Period	Fund Return %	% Rank
Year-to-Date	16.88%	4
1 Year	43.21%	2
3 Years	17.14%	4
5 Years	20.55%	1
10 Years	NA	

COMMENTARY

Fund Management versus Stated Objective – The Fund is being evaluated versus a small capitalization value benchmark and peer group. Information provided listed this Fund as a mid capitalization fund, but its current capitalization is much closer to that of a small capitalization fund.

Performance versus Benchmark – The Fund's performance versus its benchmark was exceptional. The Fund outperformed by a large margin during every time period.

Performance versus Peer Group – The Fund's performance versus other small capitalization value funds was very positive. The Fund ranked in the top 5 percent of its peer group for every time period.

Fees Comparison – The fees charged by the Fund are significantly lower than its average institutional priced small capitalization value fund in the Morningstar database. The average fund charges 106 basis points versus 70 basis points for the Fund.

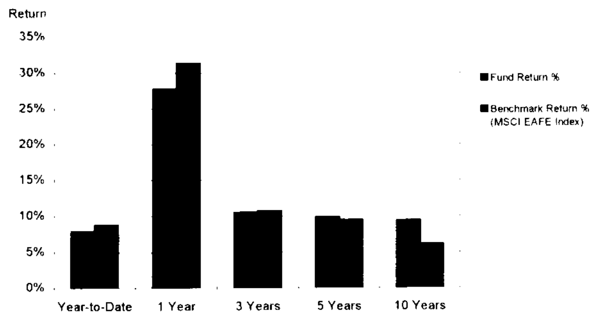
Additional Comments – Near term performance has been phenomenal, but the Fund also has experienced higher levels of risk compared with its peer group during the past three and five years. The magnitude of the returns clearly offset the additional risk of the Fund.

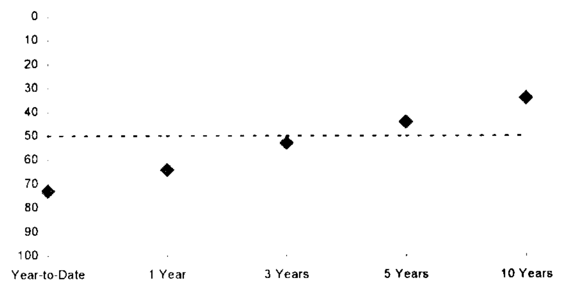
Recommendation – No change recommended.

BENCHMARK – MSCI EAFE Index

The benchmark chosen for the T. Rowe Price International Stock Fund is the MSCI EAFE Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (MSCI EAFE Index)	Difference
Year-to-Date	7.94%	8.76%	-0.82%
1 Year	27.74%	31.32%	-3.58%
3 Years	10.52%	10.73%	-0.21%
5 Years	9.76%	9.43%	0.33%
10 Years	9.40%	6.13%	3.27%

Period	Fund Return %	% Rank
Year-to-Date	7.94%	73
1 Year	27.74%	64
3 Years	10.52%	53
5 Years	9.76%	44
10 Years	9.40%	34

COMMENTARY

Fund Management versus Stated Objective – The Fund will be evaluated versus a foreign equity benchmark and peer group based on its current holdings and stated objective.

Performance versus Benchmark – The Fund has experienced underperformance versus its benchmark recently, but long-term performance is significantly better. The Fund has outperformed for the five and ten year time periods.

Performance versus Peer Group – The Fund's performance versus its peer group is similar to its performance versus its benchmark. Short-term performance is weak, yet long-term performance remains strong.

Fees Comparison – The Fund's expense ratio of 75 basis points is less than the average institutional priced foreign equity funds in the Morningstar database (110 basis points).

Additional Comments – This Fund should be monitored on a short-term basis to ensure that recent underperformance does not continue. If the underperformance does continue, it may be necessary to replace the Fund.

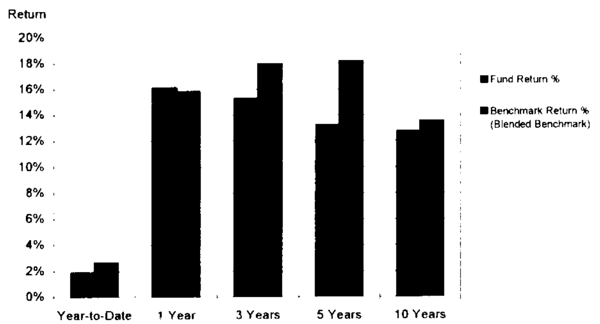
Recommendation – No recommendation to change now, but monitor closely.

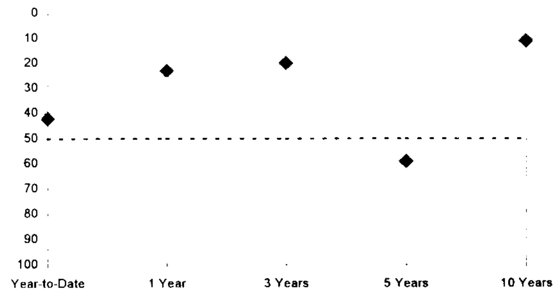
FIDELITY ASSET MANAGER FUND

BENCHMARK – Blended Index

The benchmark chosen for the Fidelity Asset Manager Fund is a blended index consisting of 60% S&P 500 Index and 40% Lehman Brothers Government Corporate Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (Blended Benchmark)	Difference
Year-to-Date	1.82%	2.64%	-0.82%
1 Year	16.12%	15.81%	0.31%
3 Years	15.25%	17.91%	-2.66%
5 Years	13.21%	18.17%	-4.96%
10 Years	12.70%	13.47%	-0.77%

Period	Fund Return %	% Rank
Year-to-Date	1.82%	42
1 Year	16.12%	23
3 Years	15.25%	20
5 Years	13.21%	59
10 Years	12.70%	11

COMMENTARY

Fund Management versus Stated Objective – Based on the asset allocation of the Fund between equity and fixed income investments, the Fund is evaluated versus a blended benchmark and a domestic hybrid peer group. The value of comparing this Fund versus other domestic hybrid funds is somewhat limited based on the variation in target asset allocation of funds included in the peer group. Despite this fact, the domestic hybrid group is the best available peer group.

Performance versus Benchmark – The Fund experienced significant underperformance versus its benchmark during the past three and five years. Other time periods show performance more consistent with the benchmark.

Performance versus Peer Group – The Fund ranks in the top half of its peer group for every time period except the five year period. The Fund has experienced significant outperformance as it ranks in the top quarter of its peer group for 1, 3 and 10 years.

Fees Comparison – The expense ratio of this Fund is 61 basis points, and is less than the average institutional priced domestic hybrid fund in the Morningstar database (88 basis points).

Additional Comments – Since the plan does not currently have pre-mixed or lifecycle funds, this Fund can be useful for individuals uncomfortable making asset allocation decisions. If lifecycle funds are added to the plan in the future, the need for this type of fund would be reduced.

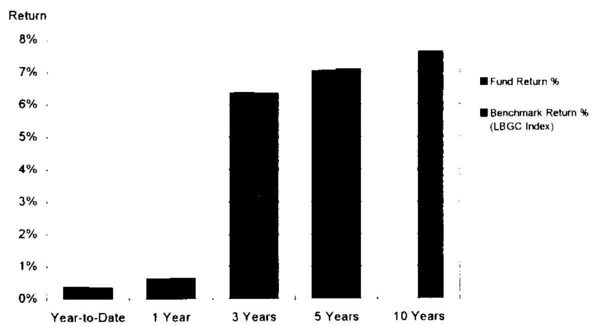
Recommendation – No change is recommended.

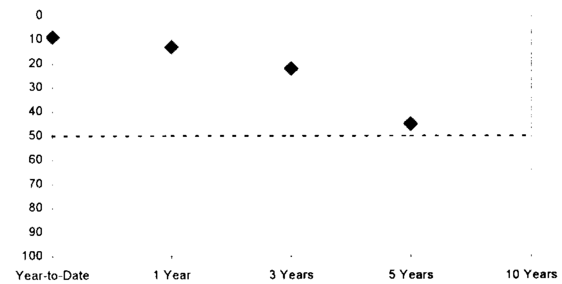
BARCLAYS INTERMEDIATE GOVERNMENT CORPORATE BOND FUND

BENCHMARK – Lehman Brothers Intermediate Government Corporate Index

The benchmark chosen for the Barclays Intermediate Government Corporate Bond Fund is the Lehman Brothers Intermediate Government Corporate Index.

PERFORMANCE





Period	Fund Return %	Benchmark Return % (LBGC Index)	Difference
Year-to-Date	0.37%	0.34%	0.03%
1 Year	0.61%	0.63%	-0.02%
3 Years	6.35%	6.33%	0.02%
5 Years	7.02%	7.06%	-0.04%
10 Years	NA	7.61%	NA

Period	Fund Return %	% Rank
Year-to-Date	0.37%	9
1 Year	0.61%	13
3 Years	6.35%	22
5 Years	7.02%	45
10 Years	NA	

COMMENTARY

Fund Management versus Stated Objective – The Fund is being managed according to its stated objective.

Performance versus Benchmark – The Fund's performance net of expenses is nearly identical to its benchmark. Gross of fees, the Fund matches or outperforms the benchmark in every time period.

Performance versus Peer Group – Recent relative performance has been particularly strong, and the Fund ranks in the top half of its peer group for all time periods. This positive relative performance argues for continued use of passive management in this asset class.

Fees Comparison – The fees charged by the Fund are low compared to other institutional priced passively managed intermediate bond Funds included in the Morningstar database.

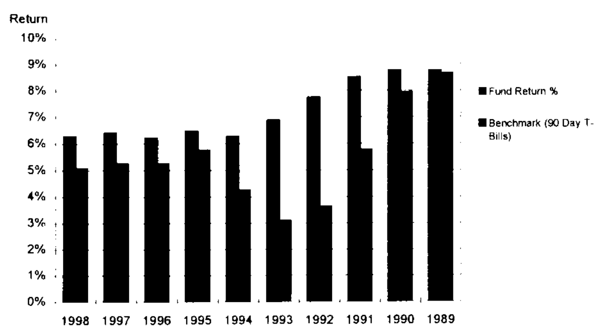
Additional Comments – The Fund is meeting its objective by matching the performance of its benchmark while maintaining a high correlation and very low expenses.

Recommendation – No change is recommended.

AETNA FIXED PLUS FUND

BENCHMARK – 90-day Treasury Bill Index – The Fund's performance is compared versus a risk free asset due to the lack of market risk inherent in this type of stable value fund. The Fund is expected to outperform since investors should be compensated for the additional credit risk since this Fund is an obligation of the issuing company's general account. There is no benchmark that can accurately reflect the returns of the stable value asset class, therefore the 90-day Treasury bill is used as the best alternative.

PERFORMANCE



Year	Fund Return %	Benchmark (90 Day T-Bills)	Difference
1998	6.27%	5.06%	1.21%
1997	6.40%	5.25%	1.15%
1996	6.20%	5.25%	0.95%
1995	6.47%	5.75%	0.72%
1994	6.26%	4.24%	2.02%
1993	6.88%	3.09%	3.79%
1992	7.73%	3.62%	4.11%
1991	8.50%	5.75%	2.75%
1990	8.75%	7.92%	0.83%
1989	8.75%	8.63%	0.12%

Note: Only calendar year performance was available.

COMMENTARY

Fund Risks – The credit risk of this Fund is linked directly to the insurance company issuing the Fund since it is paid from the general account of the company. Credit risk is non-diversified since the Fund has only one creditor, the insurance company, but this is offset by the diversified holdings of the insurance company's general account.

Performance versus Benchmark – The Fund outperforms the benchmark in each calendar year. As stated above, this is expected. The Fund will deliver a higher return to reward an investor for taking on its increased credit risk versus the benchmark.

Performance versus Peer Group – Credited rates, not security performance, determine the returns of this type of fund. As a result, comparison versus peers is of little value.

Fees Comparison – Fees are not explicit because the Fund pays a credited rate. The difference between the returns of the underlying assets and the credited rate is the true management expense of the fund. Unfortunately the insurance company does not make this information available.

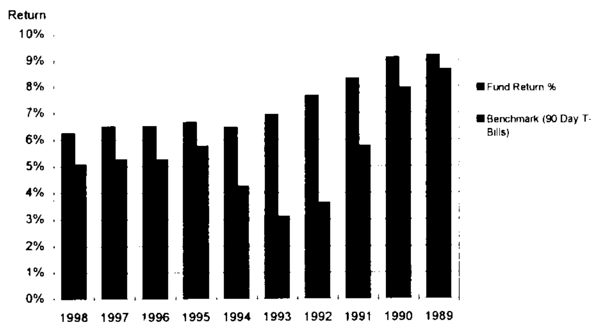
Additional Comments – While this asset class offers a low risk fund option with a higher return on average than a money market fund, liquidity restrictions limit the usefulness of this asset class. Using a stable value fund without liquidity restraints, such as an actively managed GIC/BIC fund could be substituted for this Fund and a money market fund option. This allows for a more efficient set of low risk investment options.

Recommendation – No change is recommended based on this individual Fund, but a review of the Plan's investment options in the stable value category is suggested to eliminate some redundancy in this asset class.

NATIONWIDE FIXED FUND

BENCHMARK – 90-day Treasury Bill Index – The Fund's performance is compared versus a risk free asset due to the lack of market risk inherent in this type of stable value fund. The Fund is expected to outperform since investors should be compensated for the additional credit risk since this Fund is an obligation of the issuing company's general account. There is no benchmark that can accurately reflect the returns of the stable value asset class, therefore the 90-day Treasury bill is used as the best alternative.

PERFORMANCE



Year	Fund Return %	Benchmark (90 Day T-Bills)	Difference
1998	6.24%	5.06%	1.18%
1997	6.48%	5.25%	1.23%
1996	6.49%	5.25%	1.24%
1995	6.63%	5.75%	0.88%
1994	6.44%	4.24%	2.20%
1993	6.90%	3.09%	3.81%
1992	7.64%	3.62%	4.02%
1991	8.29%	5.75%	2.54%
1990	9.09%	7.92%	1.17%
1989	9.18%	8.63%	0.55%

Note: Only calendar year performance was available.

COMMENTARY

Fund Risks – The credit risk of this Fund is linked directly to the insurance company issuing the Fund since it is paid from the general account of the company. Credit risk is non-diversified since the Fund has only one creditor, the insurance company, but this is offset by the diversified holdings of the insurance company's general account.

Performance versus Benchmark – The Fund outperforms the benchmark in each calendar year. As stated above, this is expected. The Fund will deliver a higher return to reward an investor for taking on its increased credit risk versus the benchmark.

Performance versus Peer Group – Credited rates, not security performance, determine the returns of this type of fund. As a result, comparison versus peers is of little value.

Fees Comparison – Fees are not explicit because the Fund pays a credited rate. The difference between the returns of the underlying assets and the credited rate is the true management expense of the fund. Unfortunately the insurance company does not make this information available.

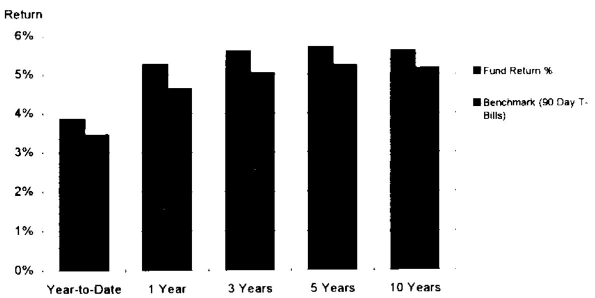
Additional Comments – While this asset class offers a low risk fund option with a higher return on average than a money market fund, liquidity restrictions limit the usefulness of this asset class. Using a stable value fund without liquidity restraints, such as an actively managed GIC/BIC fund could be substituted for this Fund and a money market fund option. This allows for a more efficient set of low risk investment options.

Recommendation – No change is recommended based on this individual Fund, but a review of the Plan's investment options in the stable value category is suggested to eliminate some redundancy in this asset class.

BARCLAYS MONEY MARKET FUND

BENCHMARK – 90-day Treasury Bill Index – The Fund's performance is compared versus a risk free asset due to the lack of market risk inherent in a money market fund. The Fund is expected to slightly outperform since investors should be compensated for the small amount of credit risk in this Fund.

PERFORMANCE



Period	Fund Return %	Benchmark (90 Day T-Bills)	Difference
Year-to-Date	3.86%	3.45%	0.41%
1 Year	5.26%	4.63%	0.63%
3 Years	5.60%	5.03%	0.57%
5 Years	5.69%	5.22%	0.47%
10 Years	5.60%	5.14%	0.46%

COMMENTARY

Fund Management versus Stated Objective – The Fund is being managed according to its stated objective, to maintain a stable share price and produce current income.

Performance versus Benchmark – The Fund outperforms the benchmark in each time period. As stated above, this slight outperformance is expected due to the Fund delivering a higher return to offset the slightly higher risk in the Fund's holdings relative to the benchmark.

Performance versus Peer Group – No information was available for this Fund's peer group.

Fees Comparison – Total fees of 4 basis points is obviously very low, but since no data is available versus peers, no relative comparison can be made. This asset class should have very low fees based on the low dispersion of performance among peer funds and the low costs involved in managing this type of fund.

Additional Comments – While this asset class offers a low risk fund option it also typically produces a low rate of return for participants. A stable value fund without liquidity restraints, such as an actively managed GIC/BIC fund could be substituted for this Fund. This type of stable value fund will tend to meet the objective of a money market fund, maintaining a stable share price, while producing higher returns for participants.

Recommendation – No change is recommended based on this individual Fund, but a review of the Plan's investment options in the stable value category is suggested to eliminate some redundancy in this asset class.

PERS' Response to PEER Actuarial Audit of Deferred Compensation Plan & Trust

I. Compliance with State and Federal Laws

A. Finding: The author of the report concluded: "In general, we believe the Plan is being administered in accordance with state and federal laws. However, there are drafting errors and omissions in the Plan documents that should be addressed. In addition, more care should be taken in communicating the salary deferral limitation to employees since these limitations take into account amounts deferred under other plans in which state employees may have access."

PERS' Response

Based on the comments made by the author, we conclude that there are neither significant problems or omissions in the Plan documentation. PERS believes that with several minor modifications we will have a document that continues to be in compliance with all applicable laws. We would note that while the Plan Document is important, the operation of the Plan within the law is a more critical issue. PERS has and will continue to comply with all applicable laws.

The author suggest changes that would enhance a better understanding of the annual and catch-up contribution limits. While PERS is amenable to any changes that would provide greater clarification to these contribution limits, it is believed that all annual and catch-up limits are clearly articulated to participants in both the written and in verbal communications.

II. Administrative Services

A. Finding: Effective July 1, 1999, the annual fee charged by SBA for these services is .25% (25 basis points) of the total Plan assets exclusive of life insurance cash values. Our understanding is that this fee is offset by any fund rebates to cover the cost of record keeping. PERS is currently in the process of obtaining competitive bids for these administrative services.

In our opinion, the level of administrative services and fee charges are appropriate and customary for the industry. Since record keeping and administrative services are now offered in a very competitive environment, we concur with the decision to seek competitive bids for these services.

PERS' Response

PERS concurs with the author that there have been major enhancements in the Plan administration over the last several years. Evaluation by PERS supports the author's contention that services and fees are appropriate and customary for the industry.

The author is in error in his statement that the fee is offset by any fund rebate to cover the cost of record keeping. Any reimbursements to the Plan, by any of the investment providers for record keeping or marketing that such investment provider does not have to perform, are allocated to the participants in that particular fund. SBA receives none of this amount, nor are such amounts used to offset fees otherwise due them.

III. Investments

A. Finding: Comparison of Investment Results

Fund	Above Average	Satisfactory	Needs Review
Aetna Growth & Income Fund	X		
Fayez Sarofim Separate Account			X
Barclays Equity Index Fund		X	
Boston Co. Daily Premier Value Equity	X		
T. Rowe Price International Stock Fund			X
Fidelity Asset Manager		X	
Barclays Int. Gov/Corp Bond Index Fund		X	
Aetna Fixed Plus		X	
Nationwide Fixed		X	
Barclays Money Market Fund		X	

PERS' Response

While we agree with the majority of these findings, we are confident that the above average rating for the Aetna Growth & Income Fund is incorrect. The PEER review examined the 1, 3, and 5-year performance as of September 30, 1999. PERS has monitored the performance of this fund for the 1-year, 3-year, and 5-year periods semi-annually from December 31, 1995 through December 31, 1997, and quarterly from June 30, 1998 through June 30, 1999. In reviewing the 1, 3, and 5 year periods ten times since January 1, 1995, we find that this fund significantly underperformed the Russell 1000 Value in eight of the ten evaluations of the 1-year period. It significantly underperformed the index all ten times for the 3 and 5 year periods. Additionally, this Fund did not perform well when compared to the Large Cap Value Mutual Fund Universe of PERS' investment consultant.

Consequently, the Fund has been closed to new participants and GE Investments has been hired to serve as the Plan's Large Cap Value Fund.

B. Finding: Evaluation of Investment Fees of the Plan

All fees appear to be below category averages as reported by Morningstar, Inc.

PERS' Response:

Not only do the investment management fees appear to be below the averages reported by Morningstar, they are below average -- and significantly so. Consider:

	Basis Points	
	Plan Fees	Morningstar Database
Aetna Growth & Income Fund	73#	81
Fayez Sarofim	23	90
BGI-S&P 500 Index	4	*
Boston Co.-Premier Value Equity	70	106
T. Rowe Price-International Stock Fund	75	110
Fidelity Asset Manager	61	88
BGI-Govt/Corp. Index Fund	4	**
BGI-Money Market Fund	4	***

reduced to 58 basis points December 1, 1999.

* no fee given but statement provided that only one fund in that asset class in the database had lower fees.
** no fee given but statement provided that fees are low compared to other institutionally priced passive, intermediate bond funds.
***stated that 4 basis points is obviously very low but no data was available via Morningstar.

As Plan administrator, we view this point as important. As an example of the annual savings due to our fee schedule, consider the 122.9 million Fayez Sarofim Equity Fund account. The average fee of 90 basis points of the Morningstar Database results in annual fees of $1,106,208. The PERS' plan fee of 23 basis points results in annual fees of $282,697.60. This translates into $823,510.40 being placed in participant's pockets each year. Significant??

C. Finding: Written evaluations of the investment options in the Plan should be completed on a quarterly basis either by qualified internal personnel or by an independent investment advisor. The evaluations should compare the investment performance versus benchmarks and peer groups to ensure that participants are receiving returns that meet reasonable expectations. Overall Plan investment option offerings should be evaluated on an annual basis.

PERS' Response:

Since 1995 semi-annual performance reviews for each fund in the Plan have been made by an independent, external investment advisor. Quarterly reviews have been made since 1998 with semi-annual presentations to the Board. Frequent meetings with key personnel from the difference funds add another dimension to the fund evaluation process.

While funds are constantly evaluated, unless there are performance strategy or personnel changes that might be detrimental to the fund's performance, PERS prefers to evaluate the overall plan investment option offerings on a three to four year schedule rather than annually as suggested. Frequent changes in the program can create confusion for participants, and are not conducive for encouraging participants to become long-term investors.

D. Finding: Addition of a small capitalization domestic equity fund. Elimination of one of the deposit administration funds and the Money Market Fund. Replace them with a stable value fund.

PERS' Response:

While we would agree that there is no exposure to a growth fund in the mid/small cap area, we would question the inference that there is no investment choice available for the more aggressive investor in the Plan. In 1997, PERS evaluated the Plan offerings and concluded that exposure to the mid and small capitalization segments of the market should be added to the Plan. Cognizant of the fact that too many options can potentially overwhelm investors, one fund was added which offers exposure to both small and mid cap stocks. The Boston Company Premier Value Equity Fund was selected specifically to provide the more aggressive investor exposure to this market.

The possible advantages of substituting a Stable Value for the Fixed funds will be explored prior to the next Plan offerings review. Given the size of PERS' fixed funds, it may be prudent at some point to establish a Stable Value fund exclusively for the Plan at some point. While Stable Value funds do offer no liquidity constraints and higher rates of return than a money market fund, they are not designed to be a money market investment vehicle. PERS would not then consider using such a fund as a substitute for the Barclay's Money Market fund.

E. Finding: Include Pre-mixed (also called Lifecycle) funds.

PERS' Response:

In the course of our 1997 investment offerings, the program was expanded to include an S&P 500 index fund, a new money market fund, as well as the previously discussed mid/small cap equity fund. Additionally, PERS conducted a search for a Lifecycle family of funds. After reviewing the proposals received from eight firms, it was found that only two had the required three-year performance track record and neither of these two had satisfactory returns.

Although there are a number of negatives associated with pre-mixed (lifestage or lifecycle) funds, PERS will revisit them as a potential investment option in the course of the next Plan offerings review.

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James Barber, Deputy Director
Ted Booth, General Counsel

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Linda Triplett, Division Manager
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