

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

Report to
the Mississippi Legislature



The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness

This report provides a comprehensive look into the decisionmaking processes of the Public Employees' Retirement System's Board of Trustees, its staff, and its contractual advisors to determine whether PERS is positioned to manage the key risks that threaten the viability of its retirement benefits programs. The major topics and conclusions of the report are as follows:

- *Board composition*--Unlike the majority of public retirement boards in the U. S., neither Mississippi's retirement board nor those in the contiguous states include citizen members as trustees. Also, while most other states' retirement boards require some trustees to possess specific qualifications or work experience, Mississippi law does not require PERS Board members to possess any specific qualifications.
- *Legal basis for the state's provision of retirement benefits*--While changes for future employees who have yet to join the public payroll could be made with a low risk of litigation, there appears to be little, if anything, that the state could do to reduce benefits of retirees or current employees without some form of compensating new advantage.
- *Financial soundness*--The financial soundness of a public pension system is more than a point-in-time comparison of assets and liabilities; it is a complex construct involving risk management strategies that help ensure that the system is always actuarially grounded, risk-informed, and sustainable over the long-term in light of all relevant environmental conditions. Although an 80% funded ratio is often cited as the standard for a financially healthy public pension system, neither the financial nor actuarial governing bodies have established a specific funded ratio as evidence of a financially healthy system. As of June 30, 2012, PERS's funded ratio was 58%.
- *Investment and risk management practices*--PERS is well organized for oversight, has access to needed investment expertise, and is supplied with the technical data needed to minimize the risks that face a defined benefit public pension system. Evidence gleaned from available actuarial assessments, investment reports, and the PERS Board's minutes and publications shows that the board has acted prudently on available information and has responded within acceptable limits to minimize key risks as they have emerged.

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 joint committee, the PEER Committee is composed of seven members of the House of Representatives appointed by the Speaker and seven 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 and three at-large members appointed from each house. 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 four Representatives and four Senators voting in the affirmative.

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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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December 11, 2012

Honorable Phil Bryant, Governor
Honorable Tate Reeves, Lieutenant Governor
Honorable Philip Gunn, Speaker of the House
Members of the Mississippi State Legislature

On December 11, 2012, the PEER Committee authorized release of the report entitled **The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness.**

A handwritten signature in black ink, appearing to read "Gary Jackson", with a long horizontal flourish extending to the right.

Senator Gary Jackson, Chair

This report does not recommend increased funding or additional staff.

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The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness

Executive Summary

Introduction

The Public Employees' Retirement System of Mississippi (PERS) was established by state law to provide retirement benefits for officers and employees in the state service and their beneficiaries. The Legislature, legislative advisors, PERS Board of Trustees, PERS staff, and contract advisors all have responsibilities in the design, funding, and management of the state's retirement system.

PEER conducted this review of PERS pursuant to the authority granted by MISS. CODE ANN. Section 5-3-51 et seq. (1972) and a specific provision of MISS. CODE ANN. Section 25-11-101 (1972), which contains the following mandate:

The Joint Legislative Committee on Performance Evaluation and Expenditure Review is hereby authorized and directed 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.

The scope and purpose of this report is to provide a comprehensive look into the decisionmaking processes of the PERS Board of Trustees, its staff, and its contractual advisors to determine whether the PERS Board is positioned to manage the key risks that threaten the viability of its retirement benefits programs.

To achieve this purpose, the PEER Committee established the following objectives for this report:

- to identify and define the roles of all parties involved (i. e., Legislature, legislative advisors, board of trustees, board staff, advisors) in the design, management, and operation of PERS;
- to clarify legal interpretations of the “contractual obligation” issues that have been raised relative to limitations on changing the benefit structure of existing plans;

- to analyze PERS's approach to meeting its long-term benefit obligations relative to competing assumptions found in professional pension system management literature;
- to explicate the processes PERS uses to allocate and manage assets among different investment options, including its approach to risk management to help ensure the financial soundness of the system; and,
- to determine the extent to which the PERS Board seeks and follows competent expert advice in carrying out its fiduciary responsibilities.

On August 9, 2011, Governor Haley Barbour established the Public Employees' Retirement System Study Commission through executive order to make recommendations on improving the financial, management, and investment structure of PERS and to publish such in a report to the Legislature and Governor. The study commission released *Recommendations on Ways to Strengthen the State's Retirement Plan* on December 14, 2011. The PEER Committee thought it appropriate to review the recommendations of the study commission and:

- to determine which, if any, of the recommendations of the Public Employees' Retirement System Study Commission have been incorporated into state law and/or PERS's operations, analyzing the basis for action or lack of action on each recommendation.

Composition of the PERS Board of Trustees (pages 15 through 24 of report)

Since 1952, the Legislature has revised the composition of the PERS Board of Trustees on four occasions, resulting in the present ten-member board structure. Mississippi's PERS Board is similar in composition to public retirement boards in the contiguous states. However, unlike the majority of retirement boards in the U. S., neither Mississippi's retirement board nor those in the contiguous states include citizen members as trustees.

Also, while the majority of retirement boards in other states require some of their trustees to possess specific qualifications or work experience, Mississippi law does not require PERS Board members to possess any specific qualifications to serve on the board. While there are no standards as to retirement board composition and member qualifications, board members as a whole should possess the skill set necessary to make informed decisions regarding investment, legal, and administrative issues.

Legal Basis for the State's Provision of PERS Benefits (pages 25 through 43 of report)

The State of Mississippi is contractually obligated to provide retirement benefits to current public employees who are in PERS-covered positions. The contractual obligation begins when employees become members of PERS upon their employment. PEER determined that:

- The United States and Mississippi constitutions contain clauses that prohibit state action that impairs the obligation of contract. These clauses protect persons who have made contracts and expect the terms of their agreements to be honored.
- Under U. S. Supreme Court authority, state actions that impair the rights private parties acquire in contracts made with the state are strictly scrutinized.
- The Mississippi Supreme Court has applied the U. S. and state contract clauses to cases involving retirement. When state action impairs a contract involving a member of PERS, the impairment must be also accompanied with “new advantages,” or it will be found unconstitutional. This legal principle is known as the “California Rule.” Generally, jurisdictions applying the California Rule protect an employee’s future accruals in a retirement system.
- The Attorney General has opined that any attempt by PERS to increase employee contributions when there are no “new advantages” given would violate the contract clauses.

PEER also notes that one reason for employees continuing public employment is because employers promise them future benefits that become a part of their contract of employment. Changes to the benefits that result in a reduction of these benefits would constitute an impairment of contract.

If the Legislature were to consider making changes to the PERS benefits structure, it would have to consider the legal ramifications of any changes affecting PERS members, summarized as follows:

- Changing benefits offered to retirees would pose a high risk of litigation.
- Changes to current employees’ future benefits without the extension of compensating new benefits or advantages would pose a high risk of litigation.
- Changing the benefits structure for future public employees would pose a low risk for litigation.

PERS and the Concept of “Financial Soundness” (pages 44 through 58 of report)

The ability to balance assets and liabilities underpins the concept of financial soundness. Under optimal conditions, the hallmark of a financially sound public pension system would be that its assets consistently meet or exceed its liabilities, a simple concept that requires due diligence and effective management over time if it is to be achieved.

When applied to a public pension system, the term *financial soundness*, in addition to its focus on balancing assets and liabilities, should be further defined as a multi-faceted construct involving an understanding of the role of *actuarial soundness*, a broadly defined view of *affordability* that encompasses sustainability, and an understanding of the role of *risk management* in the long-term financial health of the system.

- Actuarial soundness is generally viewed as a necessary component of a financially sound public pension system, but it is often used within the context of public pension systems in ways that suggest that it can also be relied upon to define financial soundness sufficiently.
- When considering the financial soundness of a public pension system, the affordability of that system is better informed by adding the broader term *sustainable*. Sustainability is the concept of being able to be upheld or defended in light of all relevant environmental conditions. A financially sound pension system is one that is sustainable in light of all relevant environmental conditions.
- A financially sound public pension system is one that is structured and operated to manage its long-term risk environment in ways that allow it a reasonable opportunity to collect or earn sufficient assets to meet its benefit obligations.

An *unfunded actuarial accrued liability* occurs when a pension system’s current actuarial value of assets is less than the present value of benefits earned by retirees, inactive members, and current employees as of the valuation date. However, when considering a pension system’s funded ratio, the American Academy of Actuaries cautions that the trend of a pension system’s funded ratios should be viewed in light of economic conditions existing at the time the funded ratios are calculated rather than focusing on a system’s funded ratio at one particular point in time.

Although an eighty percent funded ratio is often cited as the standard for a financially healthy public pension system, neither the financial or actuarial governing bodies have established a specific funded ratio as evidence of a financially healthy public pension system. PEER believes

that a public pension system's funded ratio should be viewed over a number of years to determine trends and evaluated in context of economic conditions existing during that time. PERS's funded ratio has decreased from eighty-three percent as of June 30, 2002, to fifty-eight percent as of June 30, 2012.

Regarding actions taken to decrease PERS's unfunded actuarial accrued liability, since 1990, the PERS Board of Trustees, based on recommendations from the PERS actuary, has approved increases in the employer contribution rate on six occasions, increasing the rate from 9.75% in 1990 to 14.26% in 2012. In addition, the Legislature increased the employee contribution rate from 7.25% to 9.00% effective July 1, 2010, and decreased benefits for employees hired on or after July 1, 2011.

The Governmental Accounting Standards Board has recently adopted statements setting new financial and accounting reporting standards for public pension plans that will go into effect in FY 2014 and FY 2015, respectively. The new standards reflect a major change in pension reporting and will require employers that provide a pension through PERS to report their proportionate share of the net pension obligation on their published financial statements. The statement does not address how governments approach pension plan funding.

PERS's Investment and Risk Management Practices (pages 59 through 79 of report)

Public pension systems use adherence to an asset allocation strategy over long periods to ride out fluctuations in financial markets. Systems rarely have substantial short positions, typically holding "long" positions in public securities and private investments and diversifying by using a number of asset classes, styles, managers, and approaches. Public pension systems generally attempt to maximize investment return while minimizing or eliminating exposure to risks that are unintended or for which there is no reasonable expectation of return.

PEER believes that PERS is well organized for oversight, has access to needed investment expertise, and is supplied with the technical data needed to minimize the risks that face a defined benefit public pension system. Evidence gleaned from available actuarial assessments, investment reports, and the PERS Board's minutes and publications shows that the board has acted prudently on available information and has responded within acceptable limits to minimize key risks as they have emerged.

PERS has a full range of competitively procured technical advisors to support risk mitigation efforts through direct interaction with the staff and the board and through a series of specialized reports. The PERS Board has established standards for both professional standing and scope of work for all contract professionals and firms.

PEER notes that the primary risk of any pension system is that assets will not support liabilities. PERS uses information gained from actuarial reviews, asset/liability studies, and asset allocation models to mitigate this risk. To address the risk of markets failing to achieve expected returns, PERS incorporates information from asset allocation reviews, long-term performance measurement, and experience investigations.

The PERS Board has a detailed investment policy statement that sets the stage for comprehensive asset allocation to the fund level. The asset allocation policy also sets targets and ranges for asset classes that allow for diversification into unrelated investments.

Status of Recommendations of the Public Employees' Retirement System Study Commission (pages 80 through 97 of report)

As noted previously, Governor Haley Barbour established the Public Employees' Retirement System Study Commission to make recommendations on improving the financial, management, and investment structure of PERS in order to ensure its long-term sustainability. The PERS Study Commission developed recommendations intended to help meet goals of increasing system funding while reducing contributions, with a particular focus on reducing employer contributions, which the commission considered an "undue burden on taxpayers."

The study commission recommended changes to PERS Board membership, assumptions regarding projected investment earnings and member experience, and benefits (including the annual cost of living adjustment [COLA]). The commission also recommended further analysis of issues such as the addition of a defined contribution component to the retirement program, the appropriateness of continuing the Supplemental Legislative Retirement Plan (SLRP), and the proper division of PERS-related responsibilities between the PERS Board, staff, and the Legislature.

As of the date of this report, neither the Legislature nor the PERS Board had taken any action in response to the study commission's recommendations.

Recommendations

1. While PEER acknowledges the seriousness of the funding concerns facing PERS, the Committee believes PERS's current financial condition is sufficiently sound to make any modification of current employees' and retirees' benefits legally inadvisable. Therefore, the Legislature should carefully consider PERS's October 2012 proposal for achieving an 80% funded ratio by 2042 (see page 42 of the report) as a reasonable course of action for long-term stability.
2. In preparation for an uncertain future, the Legislature should require the State Personnel Board, Department of Finance and Administration, and State Economist to study, with necessary assistance from PERS and the Attorney General, the benefits package (e. g., compensation, retirement, leave) used as an incentive to hire and retain a quality government workforce in Mississippi.

Such a study should help determine what future modifications of the retirement system, if any, might be warranted to preserve a quality government workforce and what elements should be protected, should economic conditions require significant future changes in the retirement system. The study would also provide information for policymakers to develop a more level playing field regarding total compensation of private and public sector employees who have equivalent knowledge and skill sets.

3. The PERS Board of Trustees should develop and maintain an ongoing assessment, catalog, and prioritization of possible PERS reform options that would be available to the Legislature should it request such.
4. In further acknowledgment of the largely uncharted economic course that the state and the PERS system now face, the Legislature should amend MISS. CODE ANN. Section 25-11-15 (1972) to require the PERS Board of Trustees to work with the legislative liaisons, the Attorney General, actuaries, and investment advisors to establish the elements of a risk assessment strategy that would provide both the PERS Board and the Legislature with a working definition of "imminent collapse," along with the information needed to make early identification of any threat of imminent collapse of the system. Such information would allow the Legislature to modify the benefit structure of the system for all participants based on risk, priority, and impact, should economic conditions force such change to become the only option for protecting the viability of the system.

5. The Legislature should require the PERS Board of Trustees to work with relevant control agencies or associations of state and local government to survey participating employers to determine compensation practices (e. g., “stacking,” “spiking”) that could create an excessive liability for the system. By January 1, 2014, the board should provide to the Legislature recommendations to address such practices administratively or statutorily.
6. While PEER finds no improper actions on the part of the current PERS Board, to improve the public’s confidence regarding the objectivity of the board in making decisions that affect the system, the Legislature should amend MISS. CODE ANN. Section 25-11-15 (1972) to revise the board’s composition as follows:
 - change one of the two system member positions provided for in subsection (c) (i. e., state employee members) and one of the two positions of a member receiving a retirement allowance as provided for in subsection (f) (i. e., retiree members); and,
 - replace these two members with individuals who are not members or retirees of the system, one appointed by the Governor and one appointed by the Lieutenant Governor. In making such appointments, the Governor and Lieutenant Governor should give preference to individuals with expertise in investments or financial management.

Also, the Legislature should amend subsection (b) of MISS. CODE ANN. Section 25-11-15 (1972) to state that in making this appointment (i. e., the gubernatorial appointment currently required by law), the Governor should give preference to an individual with expertise in investments or financial management.

7. As addressed by PEER in at least two previous reports (see PEER reports #191 and #273 at www.peer.state.ms.us), PERS should seek an appropriation for all of its administrative expenditures, including investment managers’ fees, trading costs, and other investment-related fees. Since PERS is a state agency and not a private corporation, it is subject to the budgetary laws of the state as well as to the Legislature’s constitutional authority to make appropriations.

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The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness

Introduction

Authority

PEER conducted this review of the Public Employees' Retirement System of Mississippi (PERS) pursuant to the authority granted by MISS. CODE ANN. Section 5-3-51 et seq. (1972) and a specific provision of MISS. CODE ANN. Section 25-11-101 (1972), which contains the following mandate:

The Joint Legislative Committee on Performance Evaluation and Expenditure Review is hereby authorized and directed 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.

Problem Statement

In the wake of the recent economic downturn, there has been growing concern over the ability of states to maintain the financial viability of their public employee retirement systems. In an issue brief released in June 2012, the Pew Center on the States reported that states have continued to struggle to fund the long-term costs of their employees' pension programs. In that Pew publication, Mississippi, along with thirty-one other states, was classified as a "serious concern" due to its funded ratio. As of June 30, 2012, Mississippi's Public Employees' Retirement System had fifty-eight percent of the funds needed to pay the projected benefits of current and future retirees.

While PEER acknowledges the seriousness of the funding concerns facing PERS, it also recognizes that the Pew report is a point-in-time perspective that does not take into consideration the long-term nature of pension plans' investment outcomes, nor does it take into consideration

recent changes that have been made to the system's design.

With the primary problem of PERS's unfunded actuarial accrued liability¹ in mind (see page 49), PEER believed that the Legislature had a need for a comprehensive view of the standards for judging the financial soundness and affordability of the system, information on challenges that could constrain PERS in addressing future funding liabilities (including major changes in system structure), and a determination of whether the PERS Board has the advisory resources and information needed to address the long-term challenge of meeting obligations under current assumptions.

Scope and Purpose

The scope and purpose of this report is to provide a comprehensive look into the decisionmaking processes of the PERS Board of Trustees, its staff, and its contractual advisors to determine whether the PERS Board is positioned to manage the key risks that threaten the viability of its retirement benefits programs.

To achieve this purpose, the PEER Committee established the following objectives for this report:

- to identify and define the roles of all parties involved (i. e., Legislature, legislative advisors, board of trustees, board staff, advisors) in the design, management, and operation of PERS;
- to clarify legal interpretations of the “contractual obligation” issues that have been raised relative to limitations on changing the benefit structure of existing plans;
- to analyze PERS's approach to meeting its long-term benefit obligations relative to competing assumptions found in professional pension system management literature;
- to explicate the processes PERS uses to allocate and manage assets among different investment options, including its approach to risk management to help ensure the financial soundness of the system; and,
- to determine the extent to which the PERS Board seeks and follows competent expert advice in carrying out its fiduciary responsibilities.

¹An *unfunded actuarial accrued liability* occurs when a pension system's current assets are less than the present value of benefits earned by retirees, inactive members, and current employees.

On August 9, 2011, Governor Haley Barbour established the Public Employees' Retirement System Study Commission through executive order to make recommendations on improving the financial, management, and investment structure of PERS and to publish such in a report to the Legislature and Governor. The study commission released *Recommendations on Ways to Strengthen the State's Retirement Plan* on December 14, 2011. The PEER Committee thought it appropriate to review the recommendations of the study commission and:

- to determine which, if any, of the recommendations of the Public Employees' Retirement System Study Commission have been incorporated into state law and/or PERS's operations, analyzing the basis for action or lack of action on each recommendation.

Due to resource limitations, PEER was not able to obtain an independent actuarial assessment of the actuarial soundness of the system, relying instead on the results of the actuarial audits currently obtained on a periodic basis under PERS Board contracts.

As noted on page 6, the acronym "PERS" is synonymous with all defined benefit plans managed by the Public Employees' Retirement System. Sections of this report related to the current plan's unfunded actuarial accrued liability or to the plan's ability to pay claims under certain scenarios pertain to the Public Employees' Retirement System alone and not to the other defined benefit plans the PERS Board administers.

According to the Internal Revenue Code, the term "general retirement system" means any pension, annuity, retirement, or similar fund or system established by a state or by a political subdivision for employees of the state, political subdivision, or both. Actuaries tend to speak of a pension fund or pension system as a common asset pool meant to generate stable growth over the long term and provide pensions for employees when they reach the end of their working years and commence retirement. Therefore, PEER uses the terms "retirement system" and "pension system" synonymously, but within their proper context, in this report.

Method

In conducting this review, PEER:

- conducted legal research:
 - Mississippi general laws regarding the establishment of and revisions to the Public Employees' Retirement System's Board of Trustees;

- statutes from the fifty states regarding board governance of retirement systems;
- case law from Mississippi and other jurisdictions regarding the constitutionality of retirement system modifications; and,
- pertinent Mississippi Attorney General’s opinions and statutes related to Mississippi’s PERS;
- reviewed and analyzed scholarly, professional, and organizational literature, reports, publications, and websites:
 - literature on the contract clause of the United States Constitution, particularly as it applies to public sector retirement programs;
 - literature on the subject of unfunded actuarial accrued liability;
 - literature to identify the key risks encountered by public pension systems and the common practices used to address those risks;
 - a memorandum from the Mississippi Center for Public Policy, prepared for the Public Employees’ Retirement System Study Commission and the Mississippi Legislature;
 - related reports of the Pew Center on the States;
 - “best practices” position statements promulgated by the Government Finance Officers Association; and,
 - the Governmental Accounting Standard Board’s statements regarding financial and accounting reporting requirements for government pension plans;
- reviewed and analyzed state government documents and information from websites:
 - report of the Public Employees’ Retirement System Study Commission entitled *Recommendations on Ways to Strengthen the State’s Retirement Plan*, released December 14, 2011;
 - Executive Order 1061 establishing the Public Employees’ Retirement System Study Commission;
 - content and disposition of retirement-related bills introduced during the 2012 Regular Session of the Mississippi Legislature; and,
 - PERS’s website for relevant information such as presentations to the study commission and

correspondence between PERS and the study commission;

- reviewed and analyzed related news articles and press releases;
- interviewed PERS staff:
 - interviewed PERS's staff to obtain their position relative to each study commission recommendation directed to the PERS Board; and,
 - interviewed PERS's Executive Director and Chief Investment Officer regarding PERS's current investment environment;
- reviewed and analyzed PERS's financial and actuarial models, documents, reports, and records:
 - financial models of the PERS system;
 - records regarding historical costs of the PERS system;
 - minutes of the PERS Board and its committees for the last four fiscal years and a purposive sampling for perspective back to 1952;
 - actuarial reports, actuarial audits, and actuarial experience studies for PERS plans;
 - PERS's asset allocation and liability studies;
 - PERS's asset allocation review for 2012;
 - PERS's asset allocation targets;
 - PERS's quarterly performance reports;
 - information packets distributed to potential PERS contractors for investment management;
 - purposive sample of PERS's investment manager contracts;
 - PERS Board's Standard Operating Procedures Manual; and,
 - PERS Board's 2012 Investment Policy Statement.

Background

As is the case with all other states in the country, Mississippi provides a retirement system for public employees of the state. Such system is to supplement benefits of the federal old-age and survivors insurance system--i. e., Social Security. In general, experts typically cite two goals for a retirement benefit—to attract and retain good employees and to allow employees to retire with adequate income on which to live.

This chapter addresses the following questions:

- What is PERS and what programs does PERS administer?
- Who are the parties involved in PERS and what are their roles?

What is PERS and what programs does PERS administer?

PERS was established by state law to provide retirement benefits for officers and employees in the state service and their beneficiaries. PERS administers seven retirement programs, referred to collectively as the “system.”

MISS. CODE ANN. Section 25-11-101 (1972) creates a retirement system for the purpose of providing retirement allowance and other benefits for officers and employees in the state service and their beneficiaries. The retirement system is a governmental defined benefit plan qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended.

The state’s retirement system consists of seven programs that are collectively referred to as the “system.” A ten-member board of trustees is responsible for establishing policies, general administration, and for the proper operation of all programs under its purview. (See page 13 and page 15 for additional information regarding the PERS Board of Trustees.)

Programs Administered by PERS

The PERS Board of Trustees manages seven retirement programs, or plans, two of which are closed to new members.

Teachers’ Retirement System of Mississippi (TRS)

The predecessor plan to the Public Employees’ Retirement System of Mississippi (PERS) was created by House Bill

143, *Laws of 1944*. The bill was passed by the Legislature effective July 1, 1944, creating the Teachers' Retirement System of Mississippi (TRS), a pension plan for certificated teachers and administrators working in the state's public schools.

In 1952, as the final push was being made for a new retirement system for state employees (see below), the Mississippi Association of Educators (MAE) recognized that the new proposed system for other public employees would provide a much better benefit system for retiring educators. Therefore, MAE petitioned the Legislature to abolish TRS and allow teachers and school administrative personnel to become members of the new system.

Active members (those still teaching) in the system at that time were transferred to the newly formed PERS. Upon closure of the legacy system, benefits being paid to those already retired became an obligation of the State of Mississippi. Administration of the payment of benefits was transferred to the PERS Board of Trustees, which continued to pay benefits to TRS retirees from funds appropriated annually by the Legislature. (As of 2007, there were no living members/retirees of the former Teachers' Retirement System.)

Public Employees' Retirement System of Mississippi (PERS)

In 1950, employees of the Mississippi Highway Department recognized the need for the state's assistance to help them save enough money to continue their standard of living throughout their retirement years. A bill was presented to the Legislature in 1950 to establish a retirement system for Highway Department employees. After review and discussion, the Legislature informed the employees that it would be necessary to establish a retirement system for all full-time state employees and employees of the state universities. The Legislature requested that a broader retirement plan bill and an estimated cost for such a plan be brought back for consideration at the 1952 session. (The Legislature previously held biennial sessions.)

In 1952, Senator Mitchell Robinson of Jackson introduced Senate Bill 273, which passed the Legislature and was signed into law by Governor Fielding Wright. The plan automatically covered all state employees; employees of the state universities and junior colleges; public school teachers and administrative personnel; school employees other than teachers and school administrative personnel where a separate agreement had been executed; and all employees of a county, city, or other instrumentality, or juristic entity of the state, or county or city-owned library, hospital, or public utility where an agreement was executed covering such employees.

Early on, the Legislature appropriated money from the General Fund to cover the retirement system's operating costs for state government employees. Local employers were charged a two percent administrative fee to cover their portion of the system's operating costs. By 1984, PERS was using investment earnings to fund its operational expenses and the fee assessed on local employers was discontinued.

The PERS defined benefit plan is a contributory plan requiring each employee to contribute a certain percentage of his or her pay and employers to pay the appropriate percentage of payroll as determined by the actuary. Other funding is provided by investment earnings.

Mississippi Highway Safety Patrol Retirement System (MHSPRS)

Initially, PERS covered all state employees, including law enforcement personnel of the state, counties, and municipalities. In 1958, the law enforcement officers of the Department of Public Safety requested the Legislature to establish a separate early retirement plan for the approximately 500 officers in the department due to the hazardous nature of their jobs. Upon enactment of the MHSPRS, the member accounts of these employees were transferred from PERS to MHSPRS. Designed exclusively for highway safety patrolmen, the new plan provided higher benefits at an earlier age than those provided for other state employees under PERS.

This plan is also financed by employee and employer contributions, as well as investment earnings on the fund. Additional funding is provided from the collection of certain motor vehicle report fees.

Mississippi Government Employees' Deferred Compensation Plan and Trust (MDC)

The state's IRC Section 457 voluntary government employees' deferred compensation plan was enacted into law in 1973 and originally placed under the oversight of the State Treasurer's Office. Administration of the plan was transferred to the PERS Board of Trustees in 1974. This plan allows governmental employees the ability to defer voluntarily a portion of their income until future years. While initially administered by PERS's staff after the transfer of the plan to PERS, this defined contribution plan is now administered by a third-party administrator under the oversight of the PERS Board and staff.

Municipal Retirement Systems (MRS)

Beginning in 1924, a series of legislation was enacted to allow certain municipalities to create retirement systems

for firemen, policemen, and certain general municipal employees. As a result of that legislation, seventeen municipalities created firemen's and policemen's disability and relief funds and two municipalities created general municipal employees' retirement systems. After years of funding and other administrative challenges, these nineteen municipal funds were closed to new membership and their administration transferred to the PERS Board of Trustees in 1987 as the Municipal Retirement Systems. While these systems require contributions from both the employee and the employer, the employer contribution to these funds has been based on a millage assessment on taxable property within the municipality.

Supplemental Legislative Retirement Plan (SLRP)

Effective July 1, 1989, the Legislature enacted a Supplemental Legislative Retirement Plan (SLRP) for members of the Legislature and the president of the Senate (i. e., the Lieutenant Governor). The plan was designed to supplement the benefits provided to members of the Legislature by PERS. Those serving when SLRP became effective had thirty days to waive membership. Those elected after July 1, 1989, automatically became members. Like PERS, SLRP is a defined benefit plan, and although members of SLRP are also mandatory members of PERS, SLRP is funded by employee and employer contributions separate from those made to PERS.

Optional Retirement Plan (ORP)

Effective July 1, 1990, the Legislature enacted the Optional Retirement Plan for new teaching and administrative faculty at the state's universities. This plan is a defined contribution 401(a) plan. New employees are allowed to choose to participate in ORP within thirty days of employment. If he or she does not elect to participate, he or she is automatically enrolled in PERS. The purpose of this plan is to give the universities the opportunity to recruit out-of-state teaching and administrative faculty who might already be participating in a similar plan.

Membership in PERS Programs

PERS has more than 384,000 participants in six retirement programs, with 99% of those participants in the public employees' retirement program.

As of June 30, 2012, the Mississippi Public Employees' Retirement System had a total membership of 384,056 in the defined benefit plans, as follows:

- Public Employees' Retirement System:
 - 162,311 active members;

- 131,141 inactive members;² and,
- 86,829 retirees and beneficiaries;
- Mississippi Highway Safety Patrol Retirement System:
 - 547 active members;
 - 54 inactive members; and,
 - 713 retirees and beneficiaries;
- Municipal Retirement Systems [closed in 1987]:
 - 25 active members;
 - 1 inactive member; and,
 - 2,016 retirees and beneficiaries; and,
- Supplemental Legislative Retirement Plan:
 - 175 active members;
 - 71 inactive members; and,
 - 173 retirees and beneficiaries.

Although a defined benefit program under the purview of PERS (see MISS. CODE ANN. Section 25-11-201 ([1972]), the Teachers' Retirement System of Mississippi presently has no living members or retirees and is a defunct program because it was the predecessor to PERS.

As of June 30, 2012, the two defined contribution plans managed by the PERS Board of Trustees had a total membership of 43,820, as follows:

- Mississippi Deferred Compensation Plan and Trust:
 - 39,372 participants; and,
- Optional Retirement Plan for the Institutions of Higher Learning:
 - 4,448 participants.

The PERS Board of Trustees also administers a PERS-sponsored retiree medical and life insurance plan. As of June 30, 2012, the insurance plan had 3,855 medical insurance participants and 6,189 life insurance participants.

Exhibit 1, page 11, provides information regarding the major benefit provisions of the three open defined benefit programs administered by the PERS Board of Trustees.

²According to PERS, an *inactive* member is a member who has separated from covered employment and who has not retired or received a refund of his or her accumulated contributions. Within the group of inactive members, some are vested and some are not. The PERS actuary considers those who are vested to be *deferred vested members* because they have liabilities associated with them other than simply a return of their accumulated employee contributions. The liabilities for inactive members who are not vested are equal to their accumulated employee contributions.

Exhibit 1: Profile of the Open Defined Benefit Programs that PERS Administrators

Plan	Public Employees' Retirement System of Mississippi	Mississippi Highway Safety Patrol Retirement System	Supplemental Legislative Retirement Plan
Plan Established	February 1, 1953	July 1, 1958	July 1, 1989
Coverage Group	Non-federal public employees	Sworn officers of the Mississippi Highway Patrol	Members of the State Legislature
Employee Contribution Rate	9% of earned compensation	7.25% of earned compensation	3% of earned compensation
Employer Contribution Rate	14.26% of earned compensation	37.00% of earned compensation	7.40% of earned compensation
Vesting Period	8 years of service as a contributing member; 4 years for those who joined before July 1, 2007	5 years of service as a contributing member	Vested in PERS
Service Retirement Eligibility	30 years of creditable service at any age--25 years for those who joined before July 1, 2011--or age 60 and vested	25 years of creditable service at any age or age 55 and vested, or 20 years of creditable service at age 45	Eligible in PERS
Cost-of-Living Adjustment	3% of annual benefit for each full fiscal year in retirement until age 60 with 3% compounding beginning at age 60; compounding beginning at age 55 for those who joined before July 1, 2011	3% of annual benefit for each full fiscal year in retirement until age 60 with 3% compounding beginning at age 60	3% of annual benefit for each full fiscal year in retirement until age 60 with 3% compounding beginning at age 60; compounding beginning at age 55 for those who joined before July 1, 2011

SOURCE: PERS.

Who are the parties involved in PERS and what are their roles?

The Legislature, legislative advisors, board of trustees, board staff, and contract advisors all have responsibilities in the design, funding, and management of the state's retirement system.

The design and management of a public sector retirement benefit program are necessarily complex. The issues surrounding such a program are highly technical, involving sophisticated calculations and esoteric financial terms. Because of the retirement system's ultimate impact on the state's budget and funding resources, the following parties must act in a collaborative manner as they carry out their particular responsibilities and collectively manage the state's retirement system: the Legislature, legislative advisors, PERS Board of Trustees, PERS staff, and PERS advisors.

Role of the Legislature

The Legislature is responsible for determining the PERS benefit structure and has statutorily set the following provisions for Mississippi's public employees' retirement plan:

- membership (MISS. CODE ANN. Section 25-11-105);
- creditable service (MISS. CODE ANN. Section 25-11-109);
- annuity payment and vesting (MISS. CODE ANN. Section 25-11-111);
- additional annual payment (cost of living adjustment [COLA]) (MISS. CODE ANN. Section 25-11-112);
- disability retirement (MISS. CODE ANN. Section 25-11-113);
- death benefits (MISS. CODE ANN. Section 25-11-114);
- payment options (MISS. CODE ANN. Section 25-11-115);
- investments (MISS. CODE ANN. Section 25-11-121); and,
- financing (MISS. CODE ANN. Section 25-11-123).

The Legislature has set similar provisions for other plans administered by the PERS Board of Trustees (i. e., the Highway Safety Patrol Retirement System and the Supplemental Legislative Retirement Plan).

While the PERS Board of Trustees has the statutory authority to set employer contribution rates (see page 53), the Legislature has responsibility for determining whether to appropriate funds to state agencies to cover such

assessments. School districts, higher education institutions, counties, municipalities, and other covered employers must also identify the funds to cover such assessments.

Role of Legislative Advisors

MISS. CODE ANN. Section 25-11-15 (12) (1972) provides authority to the Lieutenant Governor and Speaker of the House of Representatives to appoint legislative advisors to the PERS Board of Trustees (see page 16). While state law does not specifically describe the duties of the advisors, they serve as a conduit of information between the Legislature and board of trustees and a channel through which ideas and concerns may be shared.

Role of the Board of Trustees

All of the plans described on pages 6 through 9 are under the administration of the ten-member board of trustees created in MISS. CODE ANN. Section 25-11-15 (1972). The board is responsible for establishing policies governing general administration and for the proper operation of all plans under its purview. All assets, proceeds, and income of the system are held in trust (as provided for in MISSISSIPPI CONSTITUTION Section 272A) for the exclusive purpose of providing benefit payments, refunds, and administrative expenses of the system under the management of the board. Board members have a fiduciary duty to manage and invest these funds in the manner provided by law.

Board members administer the laws governing the various benefit plans, establish rules and regulations, set policy, address federal issues, recommend benefit changes when necessary, and work with both state and federal bodies. The board primarily accomplishes its work through its investment, defined contribution, administrative, audit, claims, and legislative committees.

A primary responsibility of the board is to ensure adequate funding of the plans administered by the board. MISS. CODE ANN. Section 25-11-123 (1972) provides authority for the board to set the percentage to be deducted from each member employee's paycheck each payroll period for contribution to the system. Also, CODE Section 25-11-123 provides the board with authority to set the percentage to be paid by each employer into the system based on the employer's payroll amount. The section provides that these rates shall be fixed biennially on the basis of the liabilities of the retirement system for the various allowances and benefits as shown by actuarial valuation. To assist with the setting of employer and

employee rates, the board hears actuarial reports annually on the funding of the system and adjusts, as necessary, various assumptions used to ensure that the various plans are properly funded.

Role of the PERS Staff and Advisors

MISS. CODE ANN. Section 25-11-15 (9) (1972) provides authority to the board to “employ such actuarial, clerical and other employees as are required to transact the business of the system.” The board presently employs 157 personnel assigned to five primary organizational units.

In addition to its professional staff, the board contracts with various contractors--e.g., investment consultant, investment managers--to assist with its work. (See pages 61 through 66 for more details regarding the contractors and their work.) Specifically, MISS. CODE ANN. Section 25-11-119 (1972) provides authority to the board to designate an actuary to be the technical advisor to the board on matters regarding the operation of the system.

Composition of the PERS Board of Trustees

The executive board of the Government Finance Officers Association (GFOA) has noted that public employee retirement benefit plans are typically governed by boards of trustees that act in accordance with fiduciary standards.³ This chapter addresses the following questions:

- What changes have occurred regarding the composition of the PERS Board since its creation in 1952?
- How does the composition of the PERS Board compare to that of the boards other states—specifically, Mississippi’s contiguous states?
- What are the qualifications for PERS Board members and retirement trustees in other states—specifically, Mississippi’s contiguous states?
- What “best practices” exist regarding board composition and member qualifications?

What changes have occurred regarding the composition of the PERS Board since its creation in 1952?

Since 1952, the Legislature has revised the composition of the PERS Board on four occasions, resulting in the present ten-member board structure.

Section 7 of Senate Bill 273, Regular Session 1952 (now codified as MISS. CODE ANN. Section 25-11-15 [1972]), created a ten-member Board of Trustees of the Public Employees’ Retirement System of Mississippi. The initial board consisted of the following members:

- Chair, House Appropriations Committee (ex-Officio);
- Chair, Senate Finance Committee (ex-Officio);
- State Treasurer (ex-Officio);
- State Superintendent of Education (ex-Officio);
- representative of the Mississippi Supervisors Association (elected by association membership);

³The Government Finance Officers Association (GFOA) is a national organization established to identify and develop financial policies and best practices for the professional management of governments. This and subsequent references to the GFOA’s position on retirement boards’ memberships are to a GFOA publication entitled *Best Practice: Governance of Public Employee Post-Retirement Benefits Systems*, approved by the GFOA Executive Board, March 5, 2010.

- an individual who was not a state employee who was required to have at least ten years of experience in investment banking (appointed by the Governor);
- three members of the system who each had at least ten years of creditable service, with at least one being a municipal employee (elected by the membership after initially being appointed by the Governor at the creation of the board); and,
- one classroom teacher with at least ten years of teaching experience (appointed by the Governor).

As illustrated in Exhibit 2, page 17, the Legislature revised the composition of the PERS Board in 1977, 1984, 1989, and 1993. While changes that occurred in 1977 and 1993 involved the addition of a trustee to represent retirees, those that occurred in 1984 and 1989 involved more substantive revisions to the board's composition, as discussed below:

- *1984 Changes to PERS Board Membership:* In a 1983 decision (*Alexander v. State ex rel. Allain*, 441 So. 2d 1329), the Mississippi Supreme Court ruled that legislators could not perform any tasks belonging to the executive branch. As a result, during its 1984 Regular Session, the Mississippi Legislature enacted legislation to remove legislators from executive branch boards and commissions, including the PERS Board. The legislation removed the chairs of the House Appropriations Committee and Senate Finance Committee from the PERS Board, added a trustee to represent employees of institutions of higher learning, and reduced the size of the board to ten trustees. The 1984 legislation also provided authority to the Lieutenant Governor and Speaker of the House to appoint two legislative advisors from each chamber to assist the PERS Board in its management of the trust fund.
- *1989 Changes to PERS Board Membership:* In 1989, the Legislature amended MISS. CODE ANN. Section 25-11-15 (1972) to remove the State Superintendent of Education and the classroom teacher from the PERS Board. The legislation replaced those positions with a trustee to represent employees of public schools and junior colleges. Also, the legislation removed the investment banker from the board and provided authority to the Governor to appoint an individual who is a member of the system to the PERS Board, with that person not required to have any particular skills or qualifications. In lieu of having an investment banker as a trustee, the 1989 legislation established a three-person investment advisory board appointed by the Governor, Lieutenant Governor, and Speaker of the House. Each member of the investment advisory board was required to be someone who was not a public

**Exhibit 2:
Changes in PERS Board Composition,
1952 to Present**

<i>1952</i> <i>Ten trustees</i>	<i>1977</i> <i>Eleven Trustees</i>	<i>1984</i> <i>Ten Trustees</i>
House Appropriations Chair	House Appropriations Chair	State Treasurer
Senate Finance Chair	Senate Finance Chair	State Education Superintendent
State Treasurer	State Treasurer	Retiree
State Education Superintendent	State Education Superintendent	IHL employee
County Supervisor	County Supervisor	County employee
Investment banker	Investment banker	Investment banker
Municipal employee	Municipal employee	Municipal employee
State employee	State employee	State employee
State employee	State employee	State employee
Classroom teacher	Classroom teacher	Classroom teacher
	Retiree	
		Two Senate legislative advisors
		Two House legislative advisors
<i>1989</i> <i>Nine Trustees</i>	<i>1993</i> <i>Ten Trustees</i>	
State Treasurer	State Treasurer	
Gubernatorial representative	Gubernatorial representative	
State employee	State employee	
State employee	State employee	
Municipal employee	Municipal employee	
County employee	County employee	
IHL employee	IHL employee	
Public school/Junior college employee	Public school/Junior college employee	
Retiree	Retiree	
	Retiree	
Two Senate legislative advisors	Two Senate legislative advisors	
Two House legislative advisors	Two House legislative advisors	
3-Member Investment Advisory Board	3-Member Investment Advisory Board*	

*During the 2008 Regular Session, the Legislature enacted into law House Bill 833, which amended MISS. CODE ANN. Section 25-11-15 (1972) and deleted the provision establishing the Investment Advisory Board.

SOURCE: PEER analysis of state laws.

employee but who had at least ten years' experience in investment banking or commercial banking or at least ten years' experience in managing investments. The final impact of the 1989 legislation was to reduce the number of trustees from ten to nine.

As stated on page 16, the Legislature added a trustee in 1993 to represent retirees, resulting in the PERS Board again having ten trustees. With the exception of the State Treasurer and the Governor's appointee, all trustees are elected by members of the system and represent various constituency employee groups--i. e., state, municipal, county, institutions of higher learning, public schools/junior colleges, and retirees.

How does the composition of the PERS Board compare to that of the boards of other states—specifically, Mississippi's contiguous states?

Mississippi's PERS Board is similar in composition to public retirement boards in the contiguous states. However, unlike the majority of retirement boards in the U.S., neither Mississippi's retirement board nor those in the contiguous states include citizen members as trustees.

The Government Finance Officers Association states that a post-retirement benefit system's board of trustees should be neither so large as to be unwieldy nor so small that it runs the risk of not being able to convene a quorum to make decisions. GFOA contends that the optimal board size is between seven and thirteen members, depending on the complexity of the system.

As shown in Exhibit 3, page 19, the number of trustees serving on public retirement boards throughout the United States ranges from three in Florida to twenty in Tennessee and Washington state.⁴ The average number of trustees for the boards is ten, with an average of two being ex-officio members, six being appointed, and two being elected to their positions. (The information presented in Exhibit 3 describes the primary public employees' retirement board in each state. Some states have separate systems and governing boards for other employees' systems--e. g., education, law enforcement, judicial.)

As noted previously, Mississippi's PERS Board has ten trustees. With regard to public retirement boards in Mississippi's contiguous states, those boards presently have the following number of trustees:

- Alabama: 13;

⁴In New York, the Comptroller functions as the sole trustee for the retirement system.

Exhibit 3: Composition of States' Primary Public Retirement Boards

State	Total Trustees	Ex Officio Trustees	Appointed Trustees	Elected Trustees	Qualifications Required	Citizen Members on Board
Alabama	13	4	3	6	No	No
Alaska	9	2	7	0	Yes	Yes
Arizona	9	0	9	0	Yes	Yes
Arkansas	9	3	6	0	No	No
California	13	4	3	6	Yes	Yes
Colorado	15	1	3	11	Yes	Yes
Connecticut	16	1	15	0	Yes	Yes
Delaware	7	2	5	0	No	Yes
Florida	3	3	0	0	No	No
Georgia	7	3	4	0	Yes	Yes
Hawaii	8	1	3	4	Yes	Yes
Idaho	5	0	5	0	No	Yes
Illinois	13	1	6	6	No	Yes
Indiana	9	3	6	0	Yes	Yes
Iowa	11	1	10	0	Yes	Yes
Kansas	9	1	6	2	Yes	Yes
Kentucky	9	1	3	5	Yes	Yes
Louisiana	12	3	0	9	No	No
Maine	8	1	5	2	Yes	Yes
Maryland	14	3	6	5	Yes	Yes
Massachusetts	5	1	2	2	No	Yes
Michigan	9	5	4	0	No	No
Minnesota	11	0	4	7	Yes	Yes
Mississippi	10	1	1	8	No	No
Missouri	11	2	6	3	No	No
Montana	7	0	7	0	Yes	Yes
Nebraska	9	1	8	0	Yes	Yes
Nevada	7	0	7	0	No	No
New Hampshire	13	1	12	0	Yes	Yes
New Jersey	9	1	2	6	No	Yes
New Mexico	12	2	0	10	No	No
New York*	1	1	0	0	No	No
North Carolina	14	2	12	0	No	No
North Dakota	7	1	2	4	Yes	Yes
Ohio	11	1	3	7	Yes	Yes
Oklahoma	13	3	10	0	Yes	Yes
Oregon	5	0	5	0	Yes	Yes
Pennsylvania	11	1	10	0	No	No
Rhode Island	15	4	4	7	Yes	Yes
South Carolina	5	5	0	0	No	No
South Dakota	17	1	2	14	No	Yes
Tennessee	20	9	9	2	No	No
Texas	6	0	3	3	No	No
Utah	7	1	6	0	Yes	Yes
Vermont	8	3	4	1	No	No
Virginia	9	0	9	0	Yes	Yes
Washington	20	2	18	0	No	No
West Virginia	16	4	12	0	Yes	Yes
Wisconsin	9	0	9	0	Yes	Yes
Wyoming	11	1	10	0	Yes	Yes
Average	10	2	6	2		

*In New York, the Comptroller functions as the sole trustee for the retirement system.

SOURCE: PEER analysis of states' statutes regarding public employees' retirement boards.

- Arkansas: 9;
- Louisiana: 12; and,
- Tennessee: 20.

As illustrated in Exhibit 4, page 21, public retirement boards in Mississippi’s contiguous states typically have members that are ex-officio state officials and/or department heads, appointees, and elected active public employees and retirees. In Mississippi and Louisiana, members of various constituency groups elect the majority of the trustees, while the Arkansas retirement board has no elected members and the Tennessee retirement board has only two elected trustees out of twenty. The Arkansas and Tennessee retirement boards are composed primarily of ex-officio trustees and individuals appointed by the state’s governor or other appointing authorities designated in state law.

Exhibit 3 also illustrates that the majority of public employees’ retirement boards—thirty-three—include citizen members as trustees of the system. Neither Mississippi nor any of its contiguous states include citizen members on the retirement board.

What are the qualifications for PERS Board members and retirement trustees in other states—specifically, Mississippi’s contiguous states?

While the majority of retirement boards in other states require some of their trustees to possess specific qualifications or work experience, Mississippi law does not require PERS Board members to possess any specific qualifications to serve on the board.

As stated on page 13, MISS. CODE ANN. Section 25-11-15 (1972) creates the ten-member board of trustees for the Mississippi Public Employees’ Retirement System. While the CODE provides a method for electing trustees to represent various constituency groups and requires such trustees to have at least ten years of creditable service in the retirement system, it does not require trustees to possess any particular knowledge or competencies to serve on the board.

Since the board’s creation in 1952, state law has not required PERS’s trustees to possess specific qualifications, with the exception of one trustee position. As stated on page 16, the 1952 enabling legislation provided for one trustee appointed by the Governor to the PERS Board to have at least ten years of experience in investment banking. The requirement for one trustee to have investment banking experience remained in state law until

Exhibit 4: Analysis of Public Retirement Boards' Composition, Mississippi and Contiguous States

Member	Mississippi	Alabama	Arkansas	Louisiana	Tennessee
Ex Officio					
Governor		1			
State Treasurer	1	1	1	1	1
Secretary of State					1
State Auditor			1		
State Finance Director		1	1		1
State Personnel Director		1			1
State Retirement Director					1
Comptroller of Treasury					1
Administrative Director of Courts					1
Legislative Retirement Chairs				2	
Pension Council Officers					2
Appointed by Governor					
State employee (active/retired)			3		
State employee (active)		3			
Non-state employee (active/retired)			3		
Retired higher education member					1
Police officer/firefighter					1
Member of system	1				
Appointed by Legislative Leadership					
Teacher					3
Retired teacher					1
Appointed by Associations					
County representative					2
Municipal representative					1
Elected by Members					
Active employees	2	2		6	2
Retired employees	2	2		3	
Participating employer employee		2			
Municipal employee	1				
County employee	1				
Higher education employee	1				
Public education/Junior college employee	1				
Total number of trustees	10	13	9	12	20
SOURCE: PEER analysis of contiguous states' statutes regarding public employees' retirement boards.					

1989, at which time the Legislature amended CODE Section 25-11-15 to remove certain trustees from the board, one of which was the investment banker trustee. To provide the PERS Board with investment advice, the Legislature created an Investment Advisory Board in 1989 and mandated the qualifications of board members. The Investment Advisory Board remained in existence until 2008, at which time the Legislature again amended CODE Section 25-11-15 and removed authorization for the board from state law.

With regard to Mississippi's contiguous states, none of them require their appointed or elected trustees to possess specific qualifications such as qualifications or experience in investment banking or management in order to serve on the retirement boards.

Based on an analysis of state statutes regarding public retirement boards, PEER determined that the composition of public retirement boards and qualifications of board members vary significantly throughout the United States, as described below for selected states.

- *New Mexico Public Employees Retirement Association Board* consists of twelve trustees--i. e., two ex-officio members (Secretary of State and State Treasurer), eight trustees elected by active public employees, and two trustees elected by retirees.
- *Idaho Public Employees Retirement System Board* consists of five trustees, all appointed by the Governor--i. e., two active members of the system and three Idaho citizens.
- *Montana Public Employees' Retirement Board* consists of seven trustees, all appointed by the Governor--i. e., three public employees of the system, one retired public employee, two at-large members, and one member with experience in investment management, counseling, or financial planning or who has other similar experience.
- *Arizona State Retirement System Board* consists of nine members, all appointed by the Governor--i. e., one educator member, one political subdivision employee member, one retired member, one employee member, one at-large member, and four citizen members. With exception of the citizen members, the members must all possess at least five years of administrative management experience.
- *Oregon Public Employees System Retirement Board* consists of five members, all appointed by the Governor--i. e., one state employee or elected official to

represent the management sector, one retiree or public employee to represent the labor sector, and three non-member/non-beneficiary members who possess experience in business management, pension management, or investing.

- *Virginia Retirement System Board* consists of nine members, all appointed by the Governor or Joint Rules Committee of the General Assembly--i. e., four members to represent state, local, education, and higher education employees and five members who are to be non-employees. Four non-employee members are to possess a minimum of five years of experience in the direct management, analysis, supervision, or investment of assets and the remaining non-employee member is to have a minimum of five years of experience in the management and administration of employee benefit plans.

Exhibit 3, page 19, shows that a majority of the state retirement boards—i. e., twenty-seven—stipulate certain qualifications for some of their non-ex officio members. Typically the qualifications involve a professional certification such as certified public accountant or actuary or experience in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis.

What “best practices” exist regarding board composition and member qualifications?

While there are no standards as to retirement board composition and member qualifications, board members as a whole should possess the skill set necessary to make informed decisions regarding investment, legal, and administrative issues.

GFOA takes the position that any board that operates effectively includes members who have a mix of skills, competencies, and behaviors, including leadership, teamwork, communication planning and organizational skills, and knowledge of sound decisionmaking principles. With regard to board composition, GFOA believes that the public pension board should:

. . .reflect the varied interests of those responsible for funding the plan and should include plan participants and retirees, citizens of the governmental unit, and officers of the plan sponsor, as well as independent directors.

GFOA contends that such a composition assures balanced deliberations and decisionmaking.

As described in this chapter, composition and qualifications of retirement boards are policy decisions made by each state's legislature with an eye toward the efficient administration of the state's retirement system. In general, retirement boards typically involve some combination of elected, appointed, and ex-officio members, with no particular mix being considered as "best practice." Whether the board is composed of skilled professionals, lay representatives of constituency groups, or citizens, requiring that trustees possess or obtain appropriate experience and qualifications assures that the board as a whole possesses the skill set necessary to make informed decisions regarding investment, legal, and administrative issues. However, PEER does not believe it necessary that public pension systems require expertise in investments, actuarial matters, or auditing as a precondition for all members on the board. The principal function of the board of trustees is to establish the strategic direction of the system, hire the necessary staff and consultants with the expertise to carry out that direction, and then monitor the system's performance. Board members' competencies to carry out that responsibility, for the most part, require a different skill set than that of a professional investment manager, actuary, or auditor.

In addition to any qualifications or duties that a state might establish in statute, the GFOA states that trustees are bound by fiduciary duties, which can be divided into three categories:

- *Duty of loyalty*--the obligation to act for the exclusive benefit of plan participants and beneficiaries. Regardless of the selection process, trustees should be reminded that they do not represent a specific constituency or interest group.
- *Duty of care*--the responsibility to administer the plan efficiently and properly. The duty of care includes consideration and monitoring of the financial sustainability of the plan design and funding practices.
- *Duty of prudence*--the obligation to act prudently in exercising that power or discretion over the interests that are the subject of the fiduciary relationship.

No matter their membership status on a board--i. e., ex officio, appointed, or elected--or their qualifications, public retirement board trustees must act as fiduciaries for the system. As stated by the GFOA:

. . .through prudent management, trustees, individually and collectively, must act in the best interest of all plan participants and beneficiaries.

Legal Basis for the State’s Provision of PERS Benefits

This chapter summarizes court decisions from the U. S. Supreme Court and courts of last resort from several states that have litigated constitutional issues regarding the states’ power to modify retirement benefits extended to public employees.

This chapter addresses the following questions:

- Is the state obligated to provide retirement benefits to current and former employees?
- Can contract rights be abrogated so as to reduce the state’s obligation to current members and retirees?
- What is the scope of benefits that must be provided to current members and retirees?
- In light of the state’s contractual obligation to PERS members and retirees, what are the opportunities and accompanying ramifications for changes to the PERS system?

Is the state obligated to provide retirement benefits to current and former employees?

Yes, the state is contractually obligated to provide retirement benefits to current employees who are in PERS-covered positions and to retirees. The state is not obligated to provide any retirement benefits to future employees.

Historically, many jurisdictions considered retirement systems to be mere gratuities that could be modified or eliminated at the will of the employer. While such is still the case in a few states (e. g., Texas and Indiana), most states consider the provision of pension benefits to employees and retirees to be a legally protected right.

Mississippi considers the obligation to pay a retirement benefit to current retirees and employees a right created by the contract of employment between employees who are PERS members and the employing entity, whether it is a state agency or a local governing authority. The following sections will explain the basis of this conclusion through a discussion of pertinent court decisions from the Mississippi Supreme Court, the United States Supreme Court, and an opinion of the Mississippi Attorney General.

In Mississippi, the Supreme Court has determined that members of PERS have a contractual interest in their

retirement benefits (see *Porter v. Public Employees Retirement System*, *infra*). The significance of the *Porter* decision is also discussed in the sections below.

Can contract rights be abrogated so as to reduce the state's obligation to current members and retirees?

The State of Mississippi becomes contractually obligated to employees who become members of PERS upon their employment. Likewise, modifications to benefits being paid to current retirees would appear to be immune from modification.

Contract Clauses

The United States and Mississippi constitutions contain clauses that prohibit state action that impairs the obligation of contract. These clauses protect persons who have made contracts and expect the terms of their agreements to be honored.

Laws that change the obligations of contracts are subject to judicial scrutiny under the United States and Mississippi constitutions. Both the Mississippi and United States constitutions contain provisions known colloquially as “contract clauses.” The UNITED STATES CONSTITUTION, Article 1, Section 10, cl. 1, provides:

No state shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

The Mississippi Constitution also has a similar provision. Article 3, Section 16 of the MISSISSIPPI CONSTITUTION provides:

Ex post facto laws, or laws impairing the obligation of contracts, shall not be passed.

Mississippi courts have held that the language of the contract clauses in the U. S. and state constitutions are similar and that the clauses are generally construed under the same standards. (See *Starkville v. 4-County Electric Power Association*, 909 So 2d 1094 [Miss, 2006] and *McKnight v. Mound Bayou Public School District*, 879 So 2d 493 [Miss App, 2004].)

These two clauses would likely bar legislation that would modify a party's obligation to another. Clauses such as these were considered by the constitutional framers as necessary to protect the interests of persons, often

creditors, who were at risk of having a debtor-friendly legislature enact laws that would relieve them from having to perform their contract. Perhaps the clearest statement of the contract clause's purpose was offered by Chief Justice Marshall in *Ogden v. Saunders*, 12 Wheat. 213, 354, 6 L.Ed. 606, wherein the Chief Justice noted:

The power of changing the relative situation of debtor and creditor, of interfering with contracts, a power which comes home to every man, touches the interest of all, and controls the conduct of every individual in those things which he supposes to be proper for his own exclusive management, had been used to such an excess by the state legislatures, as to break in upon the ordinary intercourse of society, and destroy all confidence between man and man. This mischief had become so great, so alarming, as not only to impair commercial intercourse, and threaten the existence of credit, but also to sap the morals of the people, and destroy the sanctity of private faith. To guard against the continuance of the evil, was an object of deep interest with all the truly wise, as well as the virtuous, of this great community, and was one of the important benefits expected from a reform of the government.

Over the years, court decisions have made it clear that not all legislative impairments were barred by the contract clauses. Indeed, much such impairment was found constitutional in the 1930s to provide limited relief for mortgagors who were financially unable to pay debts during the Great Depression. Examples of such legislation found legal include the Minnesota mortgage enforcement moratorium found constitutional in *Home Building & Loan Association v. Blaisdell et al.*, 290 U.S. 398-483 (1934) and *Wilson Banking Company Liquidating Co. v. Colvard*, 172 Miss. 804, 161 So. 123 (1936), in which the Mississippi Supreme Court upheld the constitutionality of a similar Mississippi moratorium.

These cases dealt with impairments of contracts between private individuals in which the courts found legitimate state interests in providing moratoria on mortgage foreclosure activities. Courts tend to be more skeptical when the impairments involve contracts to which the state is a party, doubtless because there is a fear that the state may use its power to wrest from private parties a better deal than the one for which it bargained.

States' Actions Regarding Contracts

Under U. S. Supreme Court authority, state actions that impair the rights private parties acquire in contracts made with the state are strictly scrutinized.

In *United States Trust Co. v. New Jersey*, 431 US 1 (1977), the United States Supreme Court was faced with a case in which the states of New Jersey and New York, parties to the management of the New York Port Authority, had chosen to abrogate by law certain bond covenants they had made to bondholders in 1962. The court found the abrogation of the loan covenants to be a violation of the contract clause.

Since *U. S. Trust*, commentators have agreed that the clause offers a degree of protection against state action that seeks to void or otherwise impair a state's contractual obligations. Courts generally follow a three-step process in determining whether an action of the state violates the clause. These steps include:

1. Is there a contract between the state and a private party that has been impaired by state action?
2. Is the state law or policy creating the impairment justified by a significant legitimate public purpose?
3. Is the state law or policy unnecessarily broad to accomplish the legitimate public purpose? (See *Novak and Rotunda*, Constitutional Law 8th ed, 2009.)

Of critical importance to analysis of pension issues are the second and third points. As in *U. S. Trust*, courts may be reluctant to conclude that the state has a legitimate interest in avoiding financial obligations that it entered into freely with its employees.

Mississippi Supreme Court's Application of Contract Clauses

The Mississippi Supreme Court has applied the U. S. and state contract clauses to cases involving retirement. When state action impairs a contract involving a member of PERS, the impairment must be also accompanied with "new advantages," or it will be found unconstitutional.

In Mississippi, the Supreme Court has addressed the issue of PERS benefits modifications in light of the contract clause in two cases. Of the greatest significance is *Public Employees Retirement System v. Porter*, 763 So 2d 845 (Miss, 2000). In *Porter*, the court was confronted with a statute that modified a member's right to designate a beneficiary. The PERS member entered the system at a time when no statute set out a mandatory provision to provide benefits to a spouse. This left the member free to designate a beneficiary. The PERS member designated his sister, Porter, as a beneficiary. Following the member's joining the system, the Legislature adopted a statute that,

among other things, created a spousal benefit regardless of the member's preferences.

In holding the statute creating the spousal benefit unconstitutional as applied in this instance, the court made clear two important principles necessary for understanding the future of possible benefit changes in the Mississippi PERS system. They are:

- For purposes of determining when a member's contractual rights attach, look to when the member's PERS employment began. In the *Porter* case, it was 1980 when the member became an employee of the city of Greenville. The law in effect at the time the person became a PERS member determines that member's rights.
- Any substantial impairment of the member's contractual rights must only be offset by a comparable increase in benefits. In the *Porter* case, there was no increase in benefits that occurred at the time the complained-of impairment occurred.

In *In Re Estate of Dillon* (632 So. 2d 1298 [Miss, 1994]), questions arose regarding an earlier version of the PERS statutes regarding spousal benefits. Under *Dillon*, the statute in question made the spouse a beneficiary of death benefits, but allowed the member to designate someone else if the member so desired. In holding that this statute did not result in an impairment of contract, the court was quick to note that the member was free to designate any beneficiary he or she so chose and that the provision creating a spousal benefit only came into play if the member did not make a choice of beneficiary. Distinguishable from *Porter*, in which the PERS member had no choice, in *Dillon*, there was a choice. The element of choice apparently made it possible for the court to conclude that there was no substantial impairment of the contract.

Several states apply the standard whereby a loss to the employee must be compensated by additional benefits or "new advantages," as some cases call the compensating benefits. Courts following this standard adhere to what has been commonly called the "California Rule."

When viewing the California Rule in light of the above-described analysis for reviewing contractual impairment cases, it is unclear whether the idea of a comparable benefit is offered as an argument for saying that the impairment is reasonable or whether it is offered as a basis for saying that the impairment is properly tailored to minimize injury to the employee member's benefits. The latter would appear to be a more reasonable position.

Attorney General's Opinion on Contractual Rights of PERS Members

The Attorney General has opined that any attempt by PERS to increase employee contributions when there are no "new advantages" given would violate the contract clauses.

Of considerable importance to an understanding of a PERS member's contractual rights is a recent opinion of Attorney General Jim Hood regarding whether the PERS Board could increase the employee contribution rate to pay for benefits previously conferred by law. In concluding that this could not be done, the Attorney General recognized two points regarding the contractual rights of PERS members:

- In *Porter*, the Mississippi Supreme Court adopted the California Rule, which requires states to grant a significant benefit if a change in the pension system would substantially impair the contractual relationship between the member and employer.
- To require an employee to pay an additional portion of salary to PERS without a substantial increase in benefits would be a violation of the contract clauses of the state and U. S. constitutions. (See *Attorney General's Opinion to Robertson*, February 22, 2010.)
- The opinion further notes that the contractual rights a PERS member has include:
 - right to an annuity as set out in CODE Section 25-11-111;
 - vested rights to benefits upon termination of the system per CODE Section 25-11-133;
 - a guarantee that benefits are to be paid by legislative appropriation in the event of a deficit of funding; and,
 - protections of Article 3, Section 16 (the contract clause) and Article 14, Sections 272A and 273, of the MISSISSIPPI CONSTITUTION OF 1890.

What is the scope of benefits that must be provided to current members and retirees?

Members have a contractually protected right in the retirement system that is in operation under the laws of the state. In cases wherein some state action diminishes a benefit provided to PERS members, there must be a compensating new advantage to offset the loss.

While Mississippi has an obligation to its current PERS member employees and retirees to pay retirement benefits, the logically following question is: "What is the scope of

the obligation?” To determine the scope, it is important to review the *Porter* case, the recent Attorney General’s opinion, and the statutes creating PERS.

In *Porter*, the court did not address specifically any benefit except for the right to identify a beneficiary that was declared by the employee when he commenced employment with the City of Greenville. While it could be argued that the case only applies to benefits already accrued (e. g., the benefit of identifying a beneficiary accrued when the employee went to work for the city of Greenville), but not future benefits, PEER would note that such a position is inconsistent with the positions taken in other jurisdictions by courts that have applied and developed constitutional tests similar to those applied in the *Porter* case. Cases from jurisdictions wherein the contract rights arise at employment, or at least when first payments are made to the retirement system, appear to grant considerable protection to the employee.

The Logic of Protecting Current Employees’ Interests in Earning Future Benefits

One reason for employees continuing public employment is because employers promise them future benefits that become a part of their contract of employment. Changes to the benefits that result in a reduction of these benefits would constitute an impairment of contract.

Several cases rendered by courts from other jurisdictions set out the logic for concluding that benefits that employees will ultimately earn are protected contractual rights.

In accepting the fact that employees whose rights arise upon employment will work for long periods of time during which changes in a retirement system occur, the Washington Supreme Court in *Washington Federation of State Employees v. Washington*, 658 P 2d 634, 1983, noted that changes in a retirement system that affected existing employees’ right to apply leave toward retirement violated the contract clause. In so ruling, the court noted that changes in laws addressing leave violated an employee’s contract rights. These rights may change over time through mutual consent. When changes are beneficial to the employee, consent is implied. When changes are not beneficial, consent will not be presumed unless some new advantage has been granted to the employee.

Likewise, in *Oregon State Police Officers’ Association v. State*, 918 P. 2d 765 (Or, 1996), the Oregon Supreme Court addressed the contractual impact of several ballot initiatives adopted that had an impact on the contracts of retirees. In the face of an argument that current case law explicating the pension contract doctrine only affected present accruals, the court made clear that the contract

rights protected include those that have accrued *and* those that may accrue at a future date. In this case, the court found that provisions requiring employees to pay six percent of their salary into PERS was an unconstitutional impairment of contract. Regarding the contribution rate required by an Oregon ballot initiative, the court noted:

The change mandated by section 10 alters the state's contractual obligation. . . .by increasing plaintiffs' cost of retirement benefits for services that, absent a lawful separation of employment, they will provide in the future. That consequence, if approved, would permit the state to retain the benefit of plaintiffs' labor, but relieve the state of the burden of paying plaintiffs what it promised for that labor. That result would frustrate plaintiffs' reasonable contractual expectations that were based on legal commitments expressly made by the state. Once offered and accepted, a pension promise made by the state is not a mirage (something seen in the distance that disappears before the employee reaches retirement). Nullification of an express term of plaintiffs' PERS contract with the state is an impairment for purposes of Contract Clause analysis, Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 247, 98 S.Ct. 2716, 57 L.Ed.2d 727 (1978). Section 10 expressly and substantially changes the state's contractual promise to plaintiffs with respect to the cost of their participation in the PERS retirement plan and the benefits that they will receive on retirement. Under section 10, the cost of participation to the employee increases while the benefits that the employee ultimately will receive on retirement decrease. Unquestionably, section 10 impairs the obligation of plaintiffs' PERS contract.

Cases from Jurisdictions Applying the California Rule

Generally, jurisdictions applying the California Rule protect an employee's future accruals in a retirement system.

Several cases from jurisdictions following the so-called "California Rule" have also made clear that employees have rights in such things as contribution rates that may not be changed without the provision of new advantages. In *In Re Opinion of Justices*, 303 NE 2d 320 (Mass, 1973), the Massachusetts Supreme Judicial Court, when asked for an advisory opinion, opined that an increase in contribution rate from five percent to seven percent for

employees currently in the system would be unconstitutional. In so opining, the justices cited the fact that the contract of employment came into existence at the time employment began and no detrimental action could be taken against employees without a new advantage.

Two cases, *Calabro v. City of Omaha*, 531 NW 2d 541 (Neb, 1994) and *Singer v. City of Topeka*, 607 P 2d 467 (Kan, 1980), both stand for the proposition that an increase in employee contributions without an attendant increase in benefits would not satisfy the reasonableness of the California Rule test applied in those jurisdictions.

Finally, in *Betts v. Board of Administration*, 21 Cal 3d 849, 148 Cal Rptr, 158 (1978), the Supreme Court of California made perhaps the strongest statement of the scope of an employee's contract right. In *Betts*, the court was faced with a change in the pension system that affected a former officer's right to draw a pension based on the current salary paid to a particular officer--in this case, the State Treasurer. Under the new system, the changes imposed would base the pension on the salary actually earned by the former officer.

In finding the change violative of the contract clause, the court stated:

... there is a strict limitation on the conditions which may modify the pension system in effect during employment. We have described the applicable principles as follows: "An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. (Citations.) Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, And [sic] changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages. (Citations.) . . ." (*Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131, 767, italics added.) We recently reaffirmed these principles in *Miller v. State of California* (1977) 18 Cal.3d 808, 816, 135 Cal.Rptr. 386.

PEER notes that in one case applying the California Rule, *Maryland State Teachers' Association v. Hughes*, 594 F.

Supp. 1353, (D. Maryland, 1983), the United States District Court for Maryland upheld a modification of the pension program that required persons to either accept a capped COLA or pay extra for an uncapped COLA. Citing the unforeseen inflation of the late 1970s and early 1980s as a cause, the courts noted that the steps taken were reasonable and necessary to provide the stability the system requires. It is not clear what benefit the retirees received; however, there is a strong implication that preserving the system was one such benefit. The court also noted the high demands the system placed on the state's funding relative to other activities of state government.

In a similar view is the case *Houghton v. City of Long Beach*, 330 P. 2d. 918 (Cal. App, 1958). The California Court of Appeals ruled that a requirement that members of a municipal retirement system pay two percent of their salary to a plan was offset by the benefit that the payments would make an insolvent plan whole and solvent again.

PEER also notes that there is not complete agreement on the scope of the contractual obligation in Mississippi.

Following the public airing of concerns regarding the financial integrity of PERS, as noted previously, Governor Haley Barbour appointed a study commission to make recommendations on improving the financial management and investment structure of PERS. The report issued by the Public Employees' Retirement System Study Commission, entitled *Recommendations on Ways to Strengthen the State's Retirement Plans*, contained several sections regarding the legal status of PERS benefits, as well as a discussion of the contract theory as it applies to the benefits of current and new employees paying into PERS.

The Public Employees' Retirement System Study Commission's Conclusions Relative to Contractual Right

The study commission's report suggests that the Porter case should be read narrowly to protect past accruals only.

The commission's report, released December 14, 2011, made the following observations about the legal environment that could impact the legality of any future changes to the PERS system:

- The Attorney General's opinion issued in 2010 finds an implied contract between the employee and the employer that constitutes a contract for life.
- Recent decisions from Minnesota and Colorado involving cost of living adjustment (COLA) modification are reasonable approaches to the state's ability to modify future accruals.

- The contractual right only protects accrued benefits. The report notes that some benefits accrue quarterly, some annually. Until actually accrued, the employee has no contractual rights.
- The *Porter* case, cited as the controlling authority in the Attorney General's opinion, is a very narrow decision about the right to designate a beneficiary and does not relate to other issues pertinent to retirement system reform. *Porter* protected the contractual right of a member to designate a beneficiary under the law in force and effect when the beneficiary joined the system. It does not clearly speak to modifications of future rights not accrued. Thus a change in law cannot change a right exercised in the past, but could change a person's right to accrue benefits in the future.
- Future employees may have their benefits impacted in any way the Legislature deems pertinent.
- Regarding retirees, the commission noted several cases in litigation that address changes in the computation of COLAs. The commission recommended a freeze on COLAs for three years and that COLAs thereafter be based on the Consumer Price Index, with a cap of three percent. The commission made no other recommendations to modify benefits.
- As to current members not retired, the commission seemed to take the position that changes could be made affecting future benefits.

Implied Contract

The commission correctly noted the effect for the Attorney General's opinion of creating an implied contract for life between the PERS member and the employer. The commission further correctly noted the narrowness of the *Porter* decision. On its facts, it deals only with a change in law that impaired a contractual decision made by Porter many years before the change in law occurred. This is a classic case of a statutory amendment impairing action taken in the past.

However, the commission gives no weight to the fact that the court has adopted the California Rule tests for determining the reasonableness of impairment--e. g., the granting of new advantages must be offered when impairment occurs.

COLA Cases in Minnesota and Colorado

Regarding the cases cited from Minnesota and Colorado, the commission misses important distinguishing points between the law in those states and the doctrine that *Porter* appears to embrace.

In *Swanson v. Minnesota Public Employees Retirement System* (Rainey County District Ct, 62 CV-10 05285, June 29, 2011), the district court granted the state's motion for summary judgment and included an opinion on all pertinent points of law. In so holding, the court found for the state in a case wherein retirees challenged the state's decision to grant the retirees a COLA less than that which they had been receiving.

The State of Minnesota did not conclude that a retirement benefit is a contractual right. The state employs the doctrine of promissory estoppel to determine which retirement member interests will be protected. In such cases, the court balances the interests of the parties. The decision notes that the COLA in Minnesota was not based on a statutory formula, but was kept flexible. In such a case, the petitioners could not make a convincing argument that their reliance on any particular method of calculating a benefit was reasonable.

Further, the Minnesota courts apply the *U. S. Trust* analysis for reviewing an impairment issue, but do not follow the California Rule that seems to require that to be reasonable, an impairment must not simply serve a substantial policy interest, but must also give new benefits or advantages to persons whose benefits are otherwise impaired. In short, Minnesota's law on point is distinguishable from Mississippi's.

Additionally, the court noted that there was uncontroverted evidence that the pension plans could be unable to pay pension benefits within the projected lives of most of the current retirees, thereby giving rise to a reasonableness argument for the change to benefit the entire system.

Regarding the Colorado court's decision in *Justus v. State of Colorado Public Employees' Retirement Board* (District Court, Denver, 2010CV1589, decided June 29, 2011), PEER notes that while Colorado is a contract state, the state was able to argue successfully that the changes in the state's COLA were legal because there never was a set formula determining what a COLA would be. Consequently, a member of the retirement system could expect a COLA, but had no reasonable basis for expecting it to be a sum certain because there was not a set formula.

The commission's offering of these as a basis for a flexible approach to retirement misses the point that in both cases, parties could not make an argument that they could reasonably expect a COLA of a certain amount. Additionally, the approach Minnesota takes to retirement is more flexible than the contract doctrine utilized in the several states that utilize such. It appears that neither case could be offered as a compelling basis for saying that changes could be made in Mississippi's retirement system when the changes would entail changing clearly

established formulas or other provisions of law that set out with certainty conditions of retirement--e. g., retirement ages or retirement benefit computation methods.

Reading of Porter Case and Changes in Future Benefits

In short, the commission takes a narrow reading of *Porter* and concludes that some modification to future benefits could be permissible. While *Porter* does not foreclose such, it is important to note the cases previously cited at page 32 wherein states that apply the California Rule have struck down changes to benefits when the law clearly set out a condition that employees could reasonably rely upon (e. g., retirement ages, a contribution percentage, applicability of leave time to retirement). They were struck down because the state could not show that new advantages were given to the employee to offset the loss that the change inflicted.

In light of the state's contractual obligation to PERS members and retirees, what are the opportunities and accompanying ramifications for changes to the PERS system?

While changes for future employees who have yet to join the public payroll could be made with a low risk of litigation, under the rule announced in *Porter*, there appears to be little, if anything, that the state could do to reduce benefits of retirees or current employees without some form of compensating new advantage.

In the event that the Legislature considers making changes to the PERS benefits structure, it should consider the legal ramifications of any changes affecting the following classes of PERS members:

- retired employees;
- current employees; and,
- future employees.

Legal Ramifications of Changing Retirees' Benefits

Changing benefits offered to retirees would pose a high risk of litigation.

Perhaps the riskiest type of change that could be considered would be a change that would impact the benefits of persons currently retired. Any action that would decrease the benefit of a retiree would be considered to be an impairment of the retiree's contract that he or she made with the state in the past. Litigation would be likely and the chances of losing would be considerable. (See Exhibit 5, page 38.)

While some states have experimented with changing the COLA for retirees, PEER notes that in Mississippi, the formula for calculating the COLA is set in statute. This setting of a formula is likely to create a reasonable expectation that the retiree would receive a COLA based on a certain formula. In both Minnesota and Colorado, as discussed above, the COLA historically fluctuated and was not set in statute.

Exhibit 5: PEER’s Assessment of Likelihood of the Risk of Legal Challenge to Potential Changes in PERS Benefits

Group	Type of Potential Change	Legal Risk
Retirees	Any*	High
Current Employees	Any change <i>without</i> compensating benefits*	High
Current Employees	Any change <i>with</i> compensating benefits**	Low
Future Employees	Any	Low

*Changes in such things as the timing of the COLA from a lump sum “thirteenth check” to twelve equal monthly installments might be accomplished without legal liability, assuming it could be proved that the employees/retirees would suffer no financial loss from the change.

**Value of the new advantage could possibly be challenged.

SOURCE: PEER analysis of statutes, case law, and Attorney General’s opinions regarding public retirement systems.

Legal Ramifications of Changing Current Employees’ Benefits

Changes to current employees’ future benefits without the extension of compensating new benefits or advantages would pose a high risk of litigation.

As can be determined from the preceding pages, there is disagreement between the Public Employees’ Retirement System Study Commission and the Attorney General regarding the scope of the *Porter* decision, particularly as it applies to constitutional protection for future accruals of benefits. The Attorney General’s opinion of 2010, noted on page 30, makes clear that in the opinion of the Attorney

General, current members of PERS have a contractually protected expectancy in a rate of contribution that cannot be changed unless there is a corresponding new advantage or benefit given to the employee. This logic could easily be extended to retirement criteria such as retirement age, years for full retirement, or application of medical and personal leave to retirement. The study commission suggested that this might be too broad a reading of the *Porter* case, upon which the Attorney General based his opinion, and that there might be allowable changes made to benefits that accrue in the future.

PEER notes that in view of the several cases from other jurisdictions that have adopted the California Rule, it is likely that persons in the PERS system would challenge the constitutionality of any changes in criteria for retirement as they apply to current members of PERS. Should the Mississippi courts follow the lead of other jurisdictions that have applied the California Rule, they would hold any changes without attendant new benefits to be unconstitutional.

In a memorandum prepared for use by the study commission and the Mississippi Legislature, it was suggested by the Mississippi Center for Public Policy, a policy and planning institute in Jackson, Mississippi, that changes that affect current public employees could be upheld as constitutional because such changes are reasonable and necessary to protect the retirement system in the face of an “imminent collapse.”⁵ Indeed, the center cites cases from jurisdictions wherein modifications of public employee contracts have been upheld in the face of contract clause arguments when the public sector defendants could show that budget cuts were necessary to sustain the viability of a program. The center cites *Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F. 3d 1012 (4 Cir, 1995) as exemplary of the ability of a legislative body to order reductions in contractual benefits prospectively in light of budget shortfalls despite the fact that the modification--forced furlough--constituted an impairment of the teachers’ contracts.

The center suggests that “impending insolvency” or “lack of financial integrity” at PERS would have to be documented in order to justify an impairment. PEER does not believe that such is documentable because:

- There is no imminent peril of PERS having an inability to pay benefits. Based on PERS’s actuary’s economic model, if:

⁵The link to the memorandum on the Mississippi Center for Public Policy’s website is dated October 10, 2011.

- the current employer contribution rate (14.26%) is not increased from this point forward; and,
- the current employee contribution rate (9%) is not increased from this point forward; and,
- earnings are only 7.5% (below PERS’s targeted 8% rate of return),

PERS would still have a projected funded ratio of 47.97% by the end of Fiscal Year 2043⁶ (see Exhibit 6, below).

Under such conditions, it appears that the system is not near insolvency and will not be in the foreseeable future.

Exhibit 6: Predictions for PERS’s Funded Ratio, End of FY 2043, With the Present Employer Contribution Rate and Varying Rates of Return on Investments

Level Employer Contribution Rate, FY 2014 - FY 2043	Level Employee Contribution Rate, FY 2014 - FY 2043	Average Rate of Return on Investments	Funded Ratio at End of FY 2043
14.26%	9.00%	8.00%	66.90%
14.26%	9.00%	7.75%	56.87%
14.26%	9.00%	7.50%	47.97%

SOURCE: Based on PERS’s actuary’s economic model. PEER strongly cautions the reader that the above predicted financial positions are based on the economic parameters noted and are not guaranteed in any manner.

- Because there is no imminent insolvency, less drastic measures could be adopted to ensure long-term financial stability of the retirement plan and it appears unlikely that a court would consider any action reducing benefits or increasing employee contributions to be reasonable and necessary if the plan was not in imminent peril of collapse.

The Mississippi Center for Public Policy also argues that anyone wishing to make modifications to current members’ benefits would be required to establish that the

⁶PEER based this calculation on PERS’s actuary’s economic model. PEER strongly cautions the reader that this predicted financial position is based on the economic parameters noted and is not guaranteed in any manner.

Legislature could not have foreseen the funding issues currently before PERS. Much of the criticism of the current PERS program and its financial integrity stems from the increase of benefits in 1999 without a corresponding increase in employee contributions (see page 81). The Legislature instead chose to fund the benefits increase by extending the unfunded actuarial accrued liability of the retirement program.

Records of PERS dating back to January 2006 show that the agency had been in regular communication with legislative leadership over the system's financial situation. During this period, legislative leadership agreed to a phase-in of employer contribution increases beginning July 1, 2006, in increments of 0.55% for the next four years. PEER notes that the July 1, 2006, increase became effective, as did the July 1, 2007, increase. Such increases for the next two fiscal years did not become effective in view of the fact that PERS's investments were performing better than they had previously. In view of the fact that PERS was apprising the legislative leadership of its needs over the past six years, it would be extremely difficult to argue that the state's policymakers are today faced with an unforeseeable fiscal crisis regarding PERS's funding needs.

Despite the state retirement system's increasing need for additional resources, the state's employer contributions to the system have not represented a large percentage of the total state budget. For the past fifteen years, state employer contributions to PERS have constituted approximately 3.75% or less of the state's total budgetary expenditures.

The previously cited Attorney General's opinion notes that the benefits adopted in 1999 were to be funded through increases in either the unfunded actuarial accrued liability or through employer contributions. At the time of the increase, member contributions could have been increased, but once they became a component of the contract, no increase could occur without an attendant increase in benefits. It could be argued that when one funds an increase in this manner, it should be foreseeable that some detriment may inure to the plan in the future. Consequently, arguing unforeseeability seems to be problematic.

Additionally, the Mississippi Center for Public Policy has raised the issue of poor market performance as a possible basis for an argument to modify current benefits. Absent some showing that the system is nearing insolvency and requiring immediate remedial action (see page 39), recent market performance would not constitute adequate legal support for changes in the system. Most financial management professionals would argue that looking at performance over a long period (e. g., thirty years) is a

better indicator of system needs than a snapshot of recent years (see page 52).

Finally, in October 2012 PERS offered a plan for improving the PERS system that appears reasonable for a thirty-year plan. The PERS Board developed a proposal, presented at its October 2012 meeting, entailing the raising of employer contributions to 15.75%. Based on PERS's actuary's economic model, assuming that the system could earn an average 8% rate of return on investments, this scenario would bring the PERS system to a funded ratio of 82.63% by the end of Fiscal Year 2042⁷ (see Exhibit 7, below). In view of this reasonable alternative, it would be difficult to argue that reductions in benefits would be a reasonable and necessary alternative.

Exhibit 7: Predictions for PERS's Funded Ratio, End of FY 2042, With an Employer Contribution Rate of 15.75% and Varying Rates of Return on Investments

Level Employer Contribution Rate, FY 2014 - FY 2042	Level Employee Contribution Rate, FY 2014 - FY 2042	Average Rate of Return on Investments	Funded Ratio, End of FY 2042
15.75%	9.00%	8.00%	82.63%
15.75%	9.00%	7.75%	71.59%
15.75%	9.00%	7.50%	61.77%

SOURCE: Based on PERS's actuary's economic model. **PEER strongly cautions the reader that the above predicted financial positions are based on the economic parameters noted and are not guaranteed in any manner.**

Several commentators on retirement law have noted that states wherein contractual rights attach at employment have little room to modify their benefits to existing members of the retirement system. (See Manahan, Amy, "Public Pension Plan Reform: the Legal Framework," *Legal Studies Research Paper Series, Research Paper No. 10-13*, University of Minnesota Law School, 2010, p. 21. See also Staman, Jennifer, *State and Local Pension Plans: A Legal Overview*, Congressional Research Service, 2011, pp. 8 and 9, as found on the website of the National Association of Retirement Administrators, www.nasra.org.)

⁷PEER based this calculation on PERS's actuary's economic model. PEER strongly cautions the reader that this predicted financial position is based on the economic parameters noted and is not guaranteed in any manner.

In summary, Exhibit 5, page 38, sets out potential benefit changes and their likelihood of risk for legal challenge. A consequence of providing by statute or common law that contractual rights arise upon employment is that employees acquire a contractual right in the benefits offered by the state. These include the provisions of law that address contributions, retirement age, and any other provision that offers a benefit.

Legal Ramifications of Changing Future Employees' Benefits

Changing the benefits structure for future public employees would pose a low risk for litigation.

Changes implemented in law for future employees could benefit the soundness of the plan and are not likely to be the basis of lawsuits against the state, although such changes could impact the state's ability to recruit future employees. (See Exhibit 5, page 38.)

Since retirement plans are, and have been, systems for recruiting and maintaining talented workforces, major changes that impact new staff would make public employment less attractive to employees. Generally, the public sector has counted on long-term employees that not only hone their skills over time, but also are keepers of institutional memory that enables institutions to function.

PERS and the Concept of “Financial Soundness”

In terms of a public pension system, “financial soundness” is a more complex construct than it at first appears. For any public pension system to be financially sound, it must first be actuarially grounded, sustainable, and risk-informed. This chapter will address:

- What is a “financially sound” retirement system?
- What are the attributes of a financially sound public pension system?

One term often used to discuss a retirement system’s financial soundness is the system’s unfunded actuarial accrued liability (UAAL). This chapter also addresses:

- What is “unfunded actuarial accrued liability?”
- What is an acceptable funded ratio for a pension system?
- What actions has PERS taken to address its unfunded actuarial accrued liability?

Finally, recent changes in statements of the Governmental Accounting Standards Board will require additional information in the notes to PERS’s financial statements and will affect how an employer that participates in PERS must report its obligation or liability for the pension provided through PERS. This chapter addresses:

- How will recent changes in Governmental Accounting Standards Board statements affect PERS?

What is a “financially sound” retirement system?

The ability to balance assets and liabilities underpins the concept of financial soundness. Under optimal conditions, the hallmark of a financially sound public pension system would be that its assets consistently meet or exceed its liabilities, a simple concept that requires due diligence and effective management over time if it is to be achieved.

The common-sense notion that a pension system must be able to produce sufficient assets to support its liabilities is strongly reflected in PERS’s contention that:

. . . a financially sound retirement plan is one that is able to honor benefit promises to retired and active members through the management and investment of assets and

*through contributions that are reasonably stable, predictable and affordable.*⁸

It is PERS's contention that a sound system is one that keeps a watchful eye on any risks that threaten application of the following formula and acts to eliminate or mitigate those risks:

(C)ontributions + (I)nterest Income = (B)enefits + (E)xpenses

(C + I = B + E)

PEER concurs with this simple construct of system soundness, but notes that in practice its application may be somewhat more complicated.

As an example, although there may be some question as to its origin, the term *financial soundness*, defined as PERS has done through this formula, has also come to be closely associated with the term *actuarial soundness* and has been widely used in state and federal statutes and regulations. The implication is that if actuarial soundness is maintained through faithful adherence to or fulfillment of assumptions, benefit promises will be honored. Experience may prove this true, but perhaps is not the whole story. Establishing the actuarial soundness of a system provides a critical anchor to ensuring the financial soundness of that system, but assumptions can be violated or unfulfilled for a variety of reasons. PEER's contention is that the complex pension environment must be clearly understood if one is to understand what makes up a sound retirement system.

What are the attributes of a financially sound public pension system?

When applied to a public pension system, the term *financial soundness*, in addition to its focus on balancing assets and liabilities, should be further defined as a multi-faceted construct involving an understanding of the role of *actuarial soundness*, a broadly defined view of *affordability* that encompasses sustainability, and an understanding of the role of *risk management* in the long-term financial health of the system.

PEER begins this process with a brief explication of the three critical terms that it believes should be associated with the idea of financial soundness:

- actuarial soundness;
- affordability; and,

⁸Excerpt from PERS Executive Director's response to the PEER Committee's June 22, 2012, interrogatory.

- risk management.

Actuarial Soundness as a Component of Financial Soundness

Actuarial soundness is generally viewed as a necessary component of a financially sound public pension system, but it is often used within the context of public pension systems in ways that suggest that it can also be relied upon to define financial soundness sufficiently.

Actuarial soundness is generally viewed as a critical component of a financially sound public pension system, but what does actuarial soundness mean?

The Actuarial Soundness Task Force of the American Academy of Actuaries, in commenting on the attributes of actuarial soundness in a May 2012 publication entitled *Actuarial Soundness*, presented an analysis of the origins and use of the term *actuarial soundness* that leaves one thinking that a fair use of the term requires that it be placed in the context of what assurances actuarially based reports actually offer their users. Viewed from this perspective, the use of the term actuarial soundness within the general context of pension systems does not appear to have a uniformly accepted meaning.

In the above-referenced publication, the academy noted that, with the exception of its appearance in the context of governmental plans, the term *actuarially sound* is not given a significant presence in describing the financial health of other types of pension plans. For example, nongovernmental plans are generally focused on the requirement that the plan use valuations that are based on best-estimate assumptions, which are widely interpreted as being central, expected-value assumptions without adjustment for or discussion of degree of risk. This seems to indicate that the use of the term *actuarial soundness* in the governmental context is a broad use of the term to provide some assurances about risk that might not have been qualified as a proper use of the term.

In a purposive sampling of states for use in its report, the American Academy of Actuaries found that in many cases where there was a reference to actuarial soundness in state law or regulation, the reference often presumed that the concept is widely understood and generally accepted, without further elaboration. For example, in its review of California law, the academy found that the legislature did not attempt a definition of actuarial soundness, but simply put the onus on the independent actuary to certify the actuarial soundness of the funding requirement. However, in another example, the Texas Pension Review Board presented the document "Guidelines for Actuarial Soundness" at its May 2, 2011, Actuarial Committee Meeting. The guidelines appear to establish objective criteria that would allow the Texas pension board to assess the state of its plans and the recommended funding

pattern and do not specifically involve the services of an actuary.

In cases in which a state either assumes that the concept of actuarial soundness is widely understood and generally accepted or places the onus on the independent actuary to certify the actuarial soundness of the funding requirement, there seems to be the unstated presumption that actuarial soundness speaks in some complete way to the question of controlling a wide variety of risks and thus speaks to the financial soundness of the system independent of the more general risk environment. This presumption is clearly subject to question and seems to suggest that an external review process, like the one undertaken by the PEER Committee in this report, must fully explicate the concept of risk relative to a public defined benefit pension plan if it is to arrive at a clear perspective on whether a given system is “financially sound.”

Affordability as a Component of Financial Soundness

When considering the financial soundness of a public pension system, the affordability of that system is better informed by adding the broader term “sustainable.” Sustainability is the concept of being able to be upheld or defended in light of all relevant environmental conditions. A financially sound pension system is one that is sustainable in light of all relevant environmental conditions.

As is implied above, risks exist over and above the risks that are mitigated through an “actuarially sound” valuation process that must be addressed if a system is to be truly judged financially sound. For example, the question of a system’s financial soundness depends not only on the system’s ability to address a wide range of risks, but also on its ability to keep in focus the dynamic interaction between any assumptions chosen for the valuation process and the policymakers’ position on affordability. As an example, two plans, one whose actuarial assumptions allow the unfunded actuarial accrued liability to be fully funded in twenty years and one whose actuarial assumptions allow the unfunded actuarial accrued liability to be fully funded in forty years, and both of which are judged to be affordable by policymakers, could both be “actuarially sound.” However, if either is judged to be unaffordable, thus making the assumption of the regular funding of actuarially determined contribution percentages questionable, the plan is not “financially sound.”

PEER emphasizes that within the context of funding a statutory public pension system, what is *affordable* is not itself a simple judgment call. Affordability must be judged in light of the contractual obligation that the state has created with its employees (pages 25 through 43 for a

discussion of the state's contractual obligations relative to pensioners). By simple definition, what is affordable is viewed as either inexpensive or "reasonably" priced. In an ideal world, that would be an adequate definition upon which to make a funding decision. However, in the case of funding an actuarially established contribution rate, the idea of affordability might be better informed by adding the broader term "sustainable." By definition, *sustainable* is the concept of being able to be upheld or defended in light of all relevant environmental conditions. A rate that might not be viewed as affordable under its simple definition might be justified as sustainable when considered in light of the bigger picture. In the case of a long-term, statutory public pension system, the required contribution rate must be actuarially sound, but it should also be defensible in light of all relevant environmental conditions, including contractual obligations involved and the potential economic consequences of abrogating that obligation.

Government is not in a position to take a simple view of affordability when it has, by its actions, obligated itself to provide certain benefits to its work force. This also highlights the importance of a government being proactive in such matters. It should make all future decisions regarding benefit structures in the context of being fully informed, because once made, such promises are extremely hard to break.

Risk Management as a Component of Financial Soundness

A financially sound public pension system is one that is structured and operated to manage its long-term risk environment in ways that allow it a reasonable opportunity to collect or earn sufficient assets to meet its benefit obligations.

As is true of any wealth management system, in order to collect the revenue and earn the investment returns necessary to fund its obligations, the system must assume certain risks. Some of these risks are inherent to the system and while manageable, are unavoidable, while others are unnecessary and avoidable, but potentially very significant to the success of the system.

Regardless of type, PEER agrees that the ability to control or eliminate certain of these risks is critical to judging a system as financially sound beyond the obvious indicator of current financial standing. In a favorable economic climate, one could have an adequately funded system that would have to be judged financially unsound because it does not have the risk management structures in place to sustain the system through a prolonged economic downturn. Another system with fewer assets and tighter margins of error may well be judged sound due to its

ability to identify and avoid or mitigate risk in a more volatile environment.

PEER acknowledges, of course, that there is a point at which assets, regardless of risk management expertise, simply cannot sustain the system through a prolonged economic downturn and meet the obligations. That issue is discussed beginning on page 44, which addresses the current solvency of the system and its ability to survive economic threats. The chapter beginning on page 59 focuses on the question of whether PERS's risk management capabilities are adequate to support its claim that it has its "finger on the pulse" of the financial soundness of the system. While time constraints did not permit a detailed analysis of the full range of risks found in a public pension system, PEER selected for analysis a range of risks that, if unattended, pose obvious threats to the ability to maintain a financially sound system.

As a backdrop to that analysis, PEER offers the following observations on the definition and use of *unfunded actuarial accrued liability* as a component in viewing the financial soundness of a public retirement system and how upcoming changes in Governmental Accounting Standards Board statements will affect reporting requirements that may subsequently affect the public's view of system soundness.

What is "unfunded actuarial accrued liability?"

An *unfunded actuarial accrued liability* occurs when a pension system's current actuarial value of assets is less than the present value of benefits earned by retirees, inactive members, and current employees as of the valuation date. However, when considering a pension system's funded ratio, the American Academy of Actuaries cautions that the trend of a pension system's funded ratios should be viewed in light of economic conditions existing at the time the funded ratios are calculated rather than focusing on a system's funded ratio at one particular point in time.

A frequently cited measure of a pension system's financial health is its funded ratio, which is the ratio of a system's current actuarial value of assets⁹ compared to accrued benefits payable.¹⁰ If the actuarial value of a pension system's assets exceeds the future benefits payable, a funding surplus exists and if the actuarial value of a pension system's assets is less than the future benefits payable, an unfunded actuarial accrued liability exists. Regardless of a pension system's funded ratio, funding

⁹As allowed under current accounting guidelines, the value of PERS's current assets is based on a five-year smoothing average in which gains and losses are recognized over five years.

¹⁰*Accrued benefits payable* is the present value of benefits earned by retirees, inactive employees, and current employees as of a particular date.

surplus, or unfunded actuarial accrued liability, a system should not be assessed based on one year's funded ratio.

In a July 2012 issue brief, the American Academy of Actuaries (AAA), the body that sets qualifications, practice, and professionalism standards for actuaries credentialed by one or more of the five U. S.-based actuarial organizations, cautions that the trend of a system's funded ratios should be viewed over several years and in light of the economic conditions existing during that time. The AAA further states that higher funded ratios are to be expected during years of economic growth and prosperity and lower funded ratios are to be expected during poor economic times and recession.

When considering a pension system's funded ratio, one should keep in mind that it is a measure of a plan's status *at one point in time* and a system's funded ratio at one point in time should not be the basis for determining or changing a system's funding policies.

Simplified, an unfunded actuarial accrued liability means a pension plan does not have all of the assets on hand required to pay the future benefits that have been earned by retirees, inactive employees, and current employees as of a particular date, such as the end of a fiscal year. The actual calculations for determining the funded ratio of a plan are more complex.

When determining the funded ratio of a pension system, an actuary calculates the value of benefits earned by employees as of the valuation date by considering factors such as how many employees are expected to receive benefits, how long the employees are expected to work for the government, and how long employees are expected to receive benefits after retirement. The actuary discounts these benefits to their present value using the government's expected return on investments set aside to pay the benefits. These calculations yield the present value of benefits earned by employees as of the valuation date. If the current actuarial value of assets on hand is less than the present value of these benefits, a pension plan has an unfunded actuarial accrued liability.

Unfunded actuarial accrued liability calculations take into consideration the expected investment return of assets on hand, but do not consider future contributions of the employer or the employees. On a personal finance level, calculating a plan's unfunded actuarial accrued liability is similar to a homeowner calculating the present value of a mortgage's principal and interest payments and comparing that obligation to the value of the homeowner's investments. In other words, this process measures whether a homeowner's savings and investments will grow fast enough to meet the future obligation of the mortgage without considering the homeowner's future salary.

By itself, an unfunded actuarial accrued liability is not an indication that a pension plan is financially troubled. It is a measure of the current actuarial value of assets on hand versus future obligations and is one factor that should be considered when reviewing the financial position of a pension system.

What is an acceptable funded ratio for a pension system?

Although an eighty percent funded ratio is often cited as the standard for a financially healthy public pension system, neither the financial nor actuarial governing bodies have established a specific funded ratio as evidence of a financially healthy public pension system. As of June 30, 2012, PERS's funded ratio was fifty-eight percent.

Reports and studies regarding public pension systems frequently quote an eighty percent funded ratio (i. e., a pension system has assets equal to at least eighty percent of the system's present value of accrued benefits payable at a particular date) as a benchmark for a financially healthy system. However, the Governmental Accounting Standards Board (GASB), an independent organization that establishes standards of accounting and financial reporting for state and local governments in the United States, has not designated any specific funded ratio as an indicator of a financially healthy pension system. The American Academy of Actuaries has also not designated any specific funded ratio as an indicator of a financially healthy pension system.

The use of an eighty percent funded ratio as a benchmark appears to have its origin in the Employee Retirement Income Security Act (ERISA) of 1974, which set minimum standards for the administration of private sector pension plans and more recently, in the Pension Protection Act (PPA) of 2006. The PPA also relates to private sector pension plans and limits benefit improvements and lump sum payments when a plan's funded ratio is below eighty percent.

Although widely quoted and accepted as a funding benchmark for public pension plans, the eighty percent funding benchmark is not set forth as a required standard for public pension plans. However, the lack of a required funded ratio does not mean a system's unfunded actuarial accrued liability should be ignored or that one particular year's funded ratio should be the basis for revising a pension system's benefits or investment strategy.

Long-Term View of Pension System Funding

A public pension system's funded ratio should be viewed over a number of years to determine trends and evaluated in context of economic conditions existing during that time.

A pension system's funded ratio should be viewed over several years to determine trends and evaluated in context of economic conditions existing during that time. As noted previously, as economic conditions fluctuate, the funded ratio of a pension system will fluctuate accordingly. During years of economic growth and prosperity, the funded ratio of a pension system typically improves. During years of slow economic growth and recession, the funded ratio of a pension system declines. In reviewing a pension system, decisions should not be based on one particular year's funded ratio or change from the previous year.

Decrease in PERS's Funded Ratio Over the Last Ten Years

PERS's funded ratio has decreased from eighty-three percent as of June 30, 2002, to fifty-eight percent as of June 30, 2012.

From June 30, 2002 to June 30, 2012, PERS's funded ratio decreased from eighty-three percent to fifty-eight percent and the amount of the unfunded actuarial accrued liability increased from approximately \$3.4 billion to approximately \$14.5 billion.

Two contributing factors to the funded ratio decline are PERS's investment return during those years and PERS not receiving the full actuarial required contribution during FY 2007 and FY 2008.

- During the last ten years, PERS's investment return on assets averaged 6.20%, as opposed to the targeted return of 8%. Investment returns ranged from a negative 19.4% during FY 2009 to 25.4% during FY 2011. Historically, PERS's investment returns have averaged 7.41% during the last twenty years and 9.63% over the last thirty years. The volatility of the recent years' returns reinforces the principle of not basing investment decisions on any one particular year's returns, but rather viewing investment returns over longer period of time and comparing long-term returns to investment return goals.

- In FY 2007, PERS's actuarial required contribution¹¹ (ARC) was funded at ninety percent and during FY 2008, the ARC was funded at ninety-seven percent. With the exception of FY 2007 and FY 2008, the ARC was fully funded during the last ten fiscal years.

Fully funding the ARC is important to keep pace with a plan's normal cost (i. e., the cost of benefits accrued in a fiscal year) and to pay toward the amortized cost of any unfunded actuarial accrued liability. If the ARC is not fully funded, the plan does not keep pace with normal cost or properly address the amortization of an unfunded actuarial accrued liability, which can lead to a decrease in the funded ratio.

What actions has PERS taken to address its unfunded actuarial accrued liability?

Since 1990, the PERS Board of Trustees, based on recommendations from the PERS actuary, has approved increases in the *employer* contribution rate on six occasions, increasing the rate from 9.75% in 1990 to 14.26% in 2012. In addition, the Legislature increased the *employee* contribution rate from 7.25% to 9.00% effective July 1, 2010, and decreased benefits for employees hired on or after July 1, 2011.

MISS. CODE ANN. Section 25-11-123 (1972) provides the PERS Board of Trustees with authority to fix employer and employee contribution rates biennially on the basis of the liabilities of the retirement system for the various allowances and benefits as shown by actuarial valuation. Effective January 1, 1990, CODE Section 25-11-123 set the employer contribution rate at 9.75% of each employer's monthly compensation obligation. Amended during the 2002 Regular Session of the Legislature, the section also required the board to reduce the employer's contribution rate by 1% each year in which the board determined and the board's actuary certified that the employer's contribution rate could be reduced by the amount without causing the unfunded accrued actuarial liability amortization period for the retirement system to exceed twenty years. With regard to employees, effective July 1, 2010, CODE Section 25-11-123 set the contribution rate at 9% of each employee's monthly earned compensation.

Typically, during its October meeting each year the PERS Board receives an actuarial valuation report on the prior fiscal year from its contract actuary. Based on recommendations from the actuary, the board discusses whether to increase employer or employee contribution rates in future fiscal years. As illustrated in Exhibit 8, page 54, the board has increased employer contribution

¹¹The *actuarial required contribution* is the annual amount required to pay a plan's normal cost (the cost of benefits accrued in a fiscal year) plus the cost to amortize the unfunded liability over a period of up to thirty years.

Exhibit 8: Increases in PERS Employer Contribution Rates Since 1990

Board Action	Employer Rate	Effective Date	Explanation of Action
12/16/03	10.75%	07/01/05	The board increased the rate from 9.75%, which had been in effect since January 1, 1990.
12/16/05	12.50%	07/01/06	Actuary's report indicated the need for a 1.75% increase in the employer rate. The board acknowledged the need to work with the Legislature to secure funding for the increase.
01/24/06	11.30%	07/01/06	Prior to the 12.50% rate becoming effective, PERS staff met with legislative leadership and reached a compromise to allow a phase-in of the employer contribution rate increase of .55% per year for four years or until the unfunded accrued liability amortization period was reduced to within the 30-year period in accordance with GASB standards. Therefore, the FY 2007 employer rate became 11.30% (10.75% + .55%)
07/01/07	11.85%	07/01/07	Additional .55% increase in accordance with the compromise effected on 1/24/06
10/23/07	11.85%	07/01/08	Continuation of prior year's rate
10/28/08	12.00%	07/01/09	Actuary's report indicated the need for only a .15% increase in the employer rate
10/27/09	13.56%	07/01/10	Actuary's report indicated the need for a 1.56% increase in the employer rate
04/27/10	12.00%	07/01/10	Due to a repeal of MISS. CODE ANN. Section 25-11-123 (which authorizes the board to set employee and employer rates) in House Bill 1 (2010 1st Extraordinary Session), the board voted to delay the implementation of the 13.56% rate until 7/1/12. Therefore, the rate remained at 12.00%
10/26/10	12.93%	07/01/11	Based on the actuary's report, the board concluded that the employer rate did not need to be increased to 13.56% due in part to the Legislature increasing the employee contribution rate.
02/23/11			Legislative leadership requested that the board delay implementation of the 12.93% rate increase until 1/1/12
02/23/11	12.93%	01/01/12	Board delayed implementation of the 12.93% employer rate as requested by legislative leadership
12/20/11	14.26%	07/01/12	Actuary's report indicated the need for a 1.33% increase in the employer rate

SOURCE: PEER analysis of board minute excerpts compiled by PERS staff.

rates on six occasions since 1990, increasing the rate from 9.75% in 1990 to 14.26% in 2012.

While the PERS Board of Trustees has authority to set the employer contribution rate, the Legislature is responsible for deciding the source of funds to cover such increases for governmental units that receive appropriations from the state—e. g., state agencies, school districts, junior/community colleges, institutions of higher learning. In recent fiscal years, the Legislature has addressed the employer contribution rate funding issues in a variety of ways. For example, to cover the 1% increase from June 30, 2005, to July 1, 2005 (FY 2006), the Legislature passed House Bill 1 (2005 Second Extraordinary Session) to use \$50 million from the state's settlement of a lawsuit with MCI to cover the employer increase. In other sessions, the Legislature included additional funds in appropriation bills to cover employer contribution rate increases. For FY 2013, the Legislature provided additional funds in the education and junior/community college appropriation bills to cover the employer contribution rate increase, but required state agencies and institutions of higher learning to absorb the increase from their appropriated funds. Board minutes document that the PERS Board's officers and staff hold discussions with key legislative leaders regarding possible rate increases and other funding issues.

With regard to the employee contribution rate, the Legislature increased the rate from 7.25% to 9% of each employee's monthly earned compensation effective July 1, 2010. In addition to increasing the employee contribution rate to address the system's unfunded actuarial accrued liability, the Legislature enacted Senate Bill 2439 during its 2011 Regular Session, which decreased benefits for employees hired on or after July 1, 2011. (See Appendix A, page 111, for a description of the reductions in PERS benefits effective July 1, 2011.)

Increases in the employer and employee contribution rates have an immediate impact in reducing the unfunded actuarial accrued liability, although the impact may not be discernable due to other factors (such as return on investments) that also impact the unfunded actuarial accrued liability. Decreases in benefits for future employees will also serve to reduce the unfunded actuarial accrued liability, although such decreases will not have a large immediate impact.

How will recent changes in Governmental Accounting Standards Board statements affect PERS?

The Governmental Accounting Standards Board has recently adopted statements setting new financial and accounting reporting standards for public pension plans that will go into effect in FY 2014 and FY 2015, respectively. The new standards reflect a major change in pension reporting and will require employers that provide a pension through PERS to report their proportionate share of the net pension obligation on their published financial statements. The statement does not address how governments approach pension plan funding.

The Governmental Accounting Standards Board (GASB), an independent organization that establishes standards of accounting and financial reporting for state and local governments in the United States, approved Statements Number 67 and 68 in June 2012 relating to financial and accounting reporting requirements for public pension systems. Statement 67 is effective beginning FY 2014 and applies to the pension plan (i. e., PERS). Statement 68 is effective beginning FY 2015 and applies to the participating employers (i. e., State of Mississippi, public schools, counties, cities). GASB Statements 67 and 68 are not funding requirements, but are reporting requirements relating to the costs associated with a government's pension plan. Earlier compliance with the statements is encouraged, but not required.

Under current GASB standards, an employer's pension obligations and costs are measured through calculation of the annual required contribution¹² (ARC) and amortizing the UAAL over a maximum of thirty years. A pension plan sponsor's pension liability is the difference between actual contributions to the plan and the ARC. Previously, if a pension plan had a UAAL, GASB standards required disclosure in the notes to the financial statements, but did not require including the UAAL on the face of the financial statements.

Under the new statements, a pension plan's net pension liability is the plan's total pension liability minus the fair value of assets held in trust for the payment of pension benefits and must be recognized in the financial statements as a liability similar to the recognition of other long-term liabilities.

¹²The *annual required contribution* is sometimes referred to as the actuarial required contribution. The actuarial required contribution is the annual amount required to pay a plan's normal cost (the cost of benefits accrued in a fiscal year) plus the cost to amortize the unfunded liability over a period of up to thirty years.

A plan's total pension liability is the projected future benefit payments to retired, inactive, and current employees and their beneficiaries. Projected salary increases and projected years of service are included in the calculation. The projected benefits are discounted to their present value using a discount rate. The expected rate of return on assets held in trust for payment of retirement benefits can be used as the discount rate to the extent those assets and projected contributions associated with active, inactive, and retired employees are expected to be sufficient to make the projected payments. After this point, a government will be required to discount the remaining projected benefit payments using a municipal borrowing rate (a tax-exempt, high-quality AA/Aa or higher twenty-year general obligation bond index rate). After being discounted to their present value, benefit payments are allocated to past, current, and future periods to better align pension expenses with the period in which the benefits are earned.

After determining the total pension liability, the fair value of a plan's assets held in trust to pay benefits is subtracted. If the total pension liability is greater than the fair value of the plan's assets, a net pension liability exists. If the fair value of the plan's assets is greater than the total pension liability, a surplus exists. Under previous GASB standards, annual gains or losses in the value of a plan's investments were added or subtracted incrementally, generally over three to five years, to smooth the effect of changes in the value of a plan's investments and reduce the volatility of a plan's reported position. Under the new standards, the fair value of the plan's investments is used without smoothing annual gains and losses. Using the fair value of a plan's assets with no smoothing of investment gains and losses has the potential to increase the volatility of a plan's reported position at the end of each fiscal year.

GASB Statement 67 will have minimal impact on PERS's financial statements because the financial information required by the new GASB statement is already included in PERS's financial statements. However, the new GASB standard will require PERS to include additional information in the notes to the financial statements. For example, information regarding the annual money-weighted rate of return on pension plan investments, net of pension plan investment expenses, will be reported. The money-weighted rate of return is a method of calculating period-by-period returns on pension plan investments that adjusts for the fluctuations in amounts actually invested.

GASB Statement 68 will require employers that provide a pension through PERS to report their proportional share of

the net pension obligation on their published financial statements. Currently, PERS plans to provide each employer with the information necessary to report their proportional share of the net pension obligation on their published financial statements. Determining and providing such information will entail additional expenses.

In summary, the new GASB standards will not dictate pension funding requirements to governments. However, the new standards will require each employer that participates in PERS (i. e., State of Mississippi, public schools, counties, cities) to show unfunded pension obligations as a liability on its financial statements. Such changes in reporting, which could bring about greater public awareness of the significant liabilities associated with unfunded pension obligations, could potentially impact a participating employer's credit rating. PEER would note that the financial rating services have been aware for some time of pension systems' unfunded pension obligations and changes to employers' future credit ratings cannot be anticipated.

PERS's Investment and Risk Management Practices

The PERS Board has adopted and implemented policies and procedures that allow it to address the common investment risks faced by all public pension systems, thus enabling it to carry out its fiduciary responsibilities to its active members and retirees. This chapter addresses:

- What are the assumptions underlying the operation of public pension systems?
- How has PERS managed risk?

What are the assumptions underlying the operation of public pension systems?

Public pension systems use adherence to an asset allocation strategy over long periods to ride out fluctuations in financial markets. Systems rarely have substantial short positions, typically holding “long” positions in public securities and private investments and diversifying by using a number of asset classes, styles, managers, and approaches. Public pension systems generally attempt to maximize investment return while minimizing or eliminating exposure to risks that are unintended or for which there is no reasonable expectation of return.

In order to conduct a sound assessment of the PERS investment and risk management environment, PEER had to develop a clear understanding of the general investment assumptions that underlie public pension systems. PEER found the needed perspective in the following key document:

Public Pension Systems: Statements of Key Investment Risks and Common Practices to Address Those Risks, published as a joint project of the Association of Public Pension Fund Auditors and Public Pension Fund Chief Investment Officers, July 2000

Although several years old, these general investment assumptions and statements on risk do not appear to have changed and, in PEER's opinion, continue to represent sound criteria for comparison. PEER heavily incorporated selected concepts of risk from this document into this chapter's analysis of the investment and risk management practices of the PERS Board.

According to the Association of Public Pension Fund Auditors, the general assumptions underlying public pension investment are as follows:

- Public pension systems use common basic investment approaches--primarily, the core discipline of

developing a long-term asset allocation and adhering to that asset allocation over long periods of time.

- Public pension systems are long-term investors, not short-term traders, and are therefore able to commit to their asset allocations and ride out fluctuations in financial markets.
- Public pension systems rarely have substantial short or leveraged positions and typically hold “long” positions in public securities and private investments.
- Public pension systems diversify by using a number of asset classes, styles, managers, and approaches.
- Public pension systems generally attempt to maximize investment return while minimizing or eliminating exposure to risks that are unintended or for which there is no reasonable expectation of return.

The following section provides an analysis of PERS’s risk management environment.

How has PERS managed risk?

PEER believes that PERS is well organized for oversight, has access to needed investment expertise, and is supplied with the technical data needed to minimize the risks that face a defined benefit public pension system. Evidence gleaned from available actuarial assessments, investment reports, and the PERS Board’s minutes and publications shows that the board has acted prudently on available information and has responded within acceptable limits to minimize key risks as they have emerged.

In order to assess the operational and financial soundness of PERS, the PEER Committee had to understand the overall risk environment in which the system functions and determine how those risks are managed. What are the risks associated with the management of a defined benefit public pension system?

In the following sections of this chapter, PEER explores the answer to this question, relying heavily on the Association of Public Pension Fund Auditors (APPFA) report as a guide, but judging for itself the pertinent risks for inclusion in this review.

In the introduction to Association of Public Pension Fund Auditors report, the authors caution the reader on how the report should be used and included the following note:

It should also be understood this document is not intended to be an exhaustive list of all risks that public pension systems may potentially encounter. Nor is it intended to be a comprehensive checklist of all the

procedures a public pension system should incorporate to address identified risks. The practices listed in this document are simply common and proven approaches that may help Systems access their approach to addressing similar issues. They are termed 'points of focus for action.' They are things that can be done to mitigate risk; but there may be numerous alternative methods and procedures to address the identified risks effectively. Consequently, the description of the key risks and possible actions are intended as examples, not as standards or prescriptions.

PEER accepts this caution and takes care in this report to assess the appropriateness of the mitigation actions taken by PERS to its specific environment, not just whether they followed the examples given in the APPFA report. With this caveat in mind, the balance of this chapter is organized using the analysis of selected risks and common practices adopted in the APPFA publication as a point of reference.

PERS's Use of Professional Advisors in Risk Management

A full range of competitively procured technical advisors supports the risk mitigation efforts of the PERS Board through direct interaction with PERS Staff and the PERS Board and through a series of specialized reports.

In order to assist it in achieving and maintaining a financially sound asset management program, the PERS Board uses a variety of management and technical information from a range of sources, including its own staff of certified public accountants, certified internal auditors, a chartered financial analyst, a certified retirement administrator, and other certificate holders in areas relevant to system oversight. For example, PERS's staff reports to the board in accordance with standard operating procedures on aspects of PERS operations, including, but not limited to:

- financial information, including the Comprehensive Annual Financial Report and audit reports;
- budget information and status of expenditures to date;
- retiree information, including number of and amount of payroll;
- investment portfolio balances, including individual portfolio balances, as well as total portfolio;
- investment performance, including review of investment managers relative to meeting their objectives;
- investment transactions;

- earnings through ancillary income;
- updates and information on the issues and events that impact the pension industry (e. g., GASB, IRS, federal legislation);
- monitor and report on legislation that might impact PERS; and,
- other information that may be relevant.

In addition to the information supplied by staff, PERS contracts with a range of professional and technical experts to supply the data and information needed for sound decisionmaking. Specific areas of advice and guidance include:

- actuarial reports, including the annual actuarial valuations for each plan, projection studies, experience investigations, actuarial audits, actuarial and funding modeling;
- financial audits, including annual financial statement audit (the auditor meets with the board annually prior to the audit and at the conclusion to report);
- investment consulting, including asset/liability modeling, investment performance reviews and commentaries, monitoring of investment manager portfolios to peers and specific benchmarks, and screening of potential manager candidates;
- investment management (these firms meet with the board to provide an update on strategy, changes at their firm, and performance);
- custodial banking (responsible for safeguarding PERS's assets, trade executions, and managing PERS's securities lending program); and,
- legal tax and investment counselors, who provide guidance and advice relative to tax compliance issues and contractual matters related to specific investment vehicles.

Currently, the PERS Board uses the following array of contract advisors to assist in managing the assets and risks of the board's various investment programs:

- one actuary (periodically, a second actuarial firm is employed to perform an audit of the current actuary);
- one general investment consulting firm;
- thirty-four investment managers to manage forty-four investment portfolios, including equities, fixed income, real estate/timber, and private equity limited partnerships;
- in conjunction with the State Department of Audit, one audit firm;

- two legal advisors, as needed, for tax advice and for advice on contractual matters related to specific investment vehicles; and,
- one custodial bank that, in conjunction with maintaining assets in a custodial capacity for PERS, manages the PERS securities lending program.

Each of these advisor groups must meet certain standards to qualify for selection and must conform to certain guidelines within which they must operate. Following are the standards that PERS's advisors must meet to qualify for selection and guidelines within which they must operate.

Standards for PERS Advisors

The PERS Board has established standards for both professional standing and scope of work of all contract professionals and firms.

Investment Managers

Investment manager qualifications vary depending on the investment mandate. Generally, managers must be a registered investment advisor; have at least five years of experience managing the type of assets for which they are being considered; have assets under management in the strategy such that PERS's assets will not represent more than twenty percent of a single investment manager's invested assets once funded; have low staff turnover and adequate research to support the investment; offer competitive fees; and have a successful track record relative to both peers and a benchmark index.

Each manager has a set of investment guidelines established and documented in the investment management or limited partnership agreement. The guidelines clearly define the types of investments that are allowed or prohibited and establish the performance expectations for each manager. As long as a manager's investment activity is conducted within specific investment guidelines, the manager has full discretion to make investment decisions within the portfolio. The PERS Investment Staff monitors each manager's investments to ensure that investment activities remain within the guidelines.

Investment Consultant

Qualifications to serve as a PERS investment consulting firm include but are not limited to: assigning a lead consultant with a minimum of ten years of investment consulting experience to the consulting team assigned to PERS; maintaining a robust and constantly updated

investment manager database covering all asset classes; having a strong investment research department that can provide studies on a variety of investment topics and strategies; having strong staff depth and experience in the area of non-traditional investing (e. g., real estate, private equity); and having the ability to provide clear and accurate manager performance reviews and the ability to provide detailed analysis of classes of investments or individual specific investments in a portfolio to determine whether the investment is performing as expected within PERS's investment plan.

Actuarial Services

When determining the qualifications of the actuary, standards prescribed by the American Academy of Actuaries technically apply to individual actuaries as opposed to actuarial firms. Below are the qualifications of the individual actuaries currently retained by PERS:

Tom Cavanaugh, Chief Executive Officer, Cavanaugh Macdonald Consulting, LLC

- Fellow of the Society of Actuaries;
- Enrolled Actuary under the Employee Retirement Income Security Act of 1974;
- Fellow of the Conference of Consulting Actuaries; and,
- Member of the American Academy of Actuaries.

Ed Koebel, Principal and Consulting Actuary, Cavanaugh Macdonald Consulting, LLC

- Enrolled Actuary under the Employee Retirement Income Security Act of 1974;
- Fellow of the Conference of Consulting Actuaries; and,
- Member of the American Academy of Actuaries.

Actuaries provide a variety of actuarial and consulting services. These services are normally very specific and are prepared based on standards prescribed by the AAA. The work products resulting from actuarial services are primarily used to advise or prescribe actions that could or should be taken. They normally are provided in the form of reports, letters, or emails to PERS management and/or the PERS Board of Trustees. Consulting services are usually requested directly by PERS management and/or the PERS Board of Trustees. These services generally seek to gain information concerning industry practices or possible effects of decision alternatives. The nature of actuarial and consulting services does not require the actuary to make a large number of independent decisions that are not prescribed by AAA standards.

External Audit Services

PERS, in conjunction with the State Department of Audit, selects external audit firms based on the firm's experience and performance on comparable engagements, the quality of the professional personnel assigned to the PERS engagement, and the support personnel and technical consultation available for the annual engagement.

All are independent certified public accounting firms charged with the responsibility of giving an opinion of the fairness of PERS's financial statements. In these matters, the auditors have complete latitude to perform all procedures deemed necessary to support their opinions. They also have the responsibility to report any material weakness in PERS's internal controls over financial reporting and compliance with laws, regulations, contracts, and other matters discovered during audits.

Legal Services

Based on the specific services identified by PERS staff prior to the selection process, staff and the Attorney General's representative develop the required qualifications and include these in the criteria used during the selection process. The qualifications differ depending on the services being sought. The firm's role is to make recommendations and to provide options for consideration by PERS's management.

Master Trust Custodial Bank

In general, the master trust custodian must be able to provide services that enable PERS to comply with state legal provisions regarding investments and with GASB's accounting and financial reporting standards. PERS's minimum standards require that respondents must have been providing master trust and custodial services for domestic and global assets for at least five years, supply an experienced account administrator, offer international custody for PERS assets, and have at least twenty-five percent of annual revenue from master trust custodial services. Organizations must meet the definition of "well capitalized" as defined by the Federal Deposit Insurance Corporation and fulfill additional total capital and surplus requirements specified in the request for proposals.

Master trust custodial bank activities operate through direct instructions by PERS's investment managers or authorized PERS staff. Terms are specified within the Master Trust Custody Agreement between PERS and the bank. However, the custodial bank performs as an advisor to PERS with respect to the securities lending program, in much the same way as a PERS investment manager. Securities lending activities are conducted within

parameters, such as authorized types of investments and collateral requirements established in the Securities Lending Agreement and Guarantee, also between PERS and the master trust custodial bank. The bank has discretion to make securities lending transaction decisions as long as the activity is conducted within the specified parameters. The PERS Investment Staff monitors securities lending transactions to ensure that activities remain within the contract guidelines.

Managing Risks of a Defined Benefit Public Pension System

The primary risk of any pension system is that assets will not support liabilities. However, there are tools that, if properly placed and utilized, can mitigate the negative consequences of these risks.

Major Subcategories of Risk

Two subcategories of risk should be addressed by the system: liabilities not behaving as expected and assets not behaving as expected.

As noted previously, the primary risk to a defined benefit public pension system is that the assets will not support the liabilities. According to the APPFA publication, two subcategories of risk contribute to this primary risk:

- *Liabilities of the fund will not behave as expected*-for example, unexpected changes in benefits (e. g., employees are given the option to retire earlier) or demographics (e. g., people live longer).
- *The assets of the fund will not behave as expected*-for example, market volatility (e. g., stock markets crash in unexpected ways) or subpar performance of asset managers (e. g., managers do not live up to performance requirements).

In assessing the PERS Board's risk management environment, PEER chose to follow the Association of Public Pension Fund Auditors' lead and focus most of the efforts for this report on the investment risks associated with the assets of a public pension system not behaving as expected. However, discussion of risk management concerns associated with the liabilities of a pension system failing to behave as expected will be interwoven at relevant points into the discussion where the specific context of changes in liability affect asset requirements and shed light on the issues facing PERS in meeting its obligations.

Tools to Address Risk of Assets Not Supporting Obligations

Public pensions use three primary tools to address the risk of assets not supporting obligations.

The APPFA publication suggests that public pension plans can address the risk of assets not supporting liabilities stemming from either source through the implementation of three basic oversight procedures:

- actuarial reviews;
- asset/liability studies; and,
- asset allocation models.

Actuarial Reviews

The PERS Board makes effective use of a full range of actuarial reports to reduce its risks and maintain a well-informed investment environment, thus contributing to its ability to protect the financial soundness of the system.

As noted previously, public pension systems have *actuarial reviews* conducted to evaluate the trends of the liability components of the system relative to existing assets. Referred to as an “annual actuarial valuation,” the specific purpose of the actuarial review is to measure a plan’s funding progress and to determine the unfunded actuarial accrued liability amortization period for the plan. Currently, the PERS Board authorizes an annual actuarial review for each plan that it administers.

The valuations published by PERS in 2012 were conducted through Cavanaugh Macdonald Consulting, LLC, by and under the supervision of independent actuaries who are all members of the American Academy of Actuaries and are qualified by that academy to render the opinions provided (see page 64). These regular actuarial evaluations measure the system’s present financial position and adequacy of contributions by calculating the relationship of the system’s assets to its liabilities. These reports also use actuarial projections to develop cash flow patterns for investment policy and asset mix discussions, model future experience assumptions, analyze the funding impact of changes in the workforce, and examine the potential for changes in benefits relative to system finances. The tables and schedules provided in these annual reviews give the PERS Board the actuarial oversight needed to provide a sound basis for decisionmaking.

In addition to the annual actuarial reviews discussed above, PERS also obtains periodic *actuarial audits* to provide an important check on the content of the actuarial review process by auditing the work performed by the original actuary. The audit is performed by a firm with

actuarial credentials equal to those of the retained actuary. The most recent actuarial audits of PERS were conducted in the spring of 2011 by the consultants and actuaries firm of Gabriel, Roeder, Smith & Company.

The actuarial audits review the most recent actuarial valuation and replicate the valuation through case studies and test cases drawn from various classes of employees. Findings are then classified into categories reflecting an increasing need for action and change to make the actuarial review process sound and productive. For example, the PERS actuarial audit of June 30, 2010, revealed no critical or material findings. A critical finding or recommendation is one that needs to be addressed immediately and immediate changes made. A material finding or recommendation stems from conditions revealed in the replication that should be addressed and could have a material effect on calculation results for PERS in total.

The concluding opinion of Gabriel, Roeder, Smith & Company was that the original actuarial valuation represented a reasonable estimate of the liabilities of PERS, although the audit reported study findings and best practices findings.¹³ In addition, Gabriel, Roeder, Smith, & Company was able to produce independently the liabilities of PERS and the computed contribution rate within acceptable tolerances using current methods and assumptions.

Asset/Liability Studies

Periodic asset/liability studies allow the PERS Board to make informed decisions when considering proposed changes in investment policy, funding/contribution policy, or benefits policy. Active use of these studies by the PERS Board helps to mitigate the risks of assets not supporting liabilities.

PERS periodically uses *asset/liability studies* to identify changes in the relationships between the assets and liabilities of a pension fund based on three key policy areas that govern all public pension plans. The goal is to evaluate the interaction of investment policy, funding/contribution policy, and benefits policy in an effort to improve or refine investment policy in critical ways. (See page 76 for a discussion of the PERS Board's investment policy.)

Some of the key questions asked with regard to investment policy are as follows: How will the assets supporting the benefits be invested? What are appropriate risk/return objectives? How are cash flows to be

¹³A *study finding* is not a critical finding, but one that should be reviewed for change by the actuary, PERS's staff, or both to improve the actuarial review process. *Best practices findings* represent what the actuarial auditor believes should be best practices for plans similar to PERS.

managed? Key funding/contribution policy questions are: How will the benefits be funded? What is the actuarial discount rate? How will deficits be amortized? Benefits policy questions are: What types of benefits are offered? What level of benefits is offered? When and to whom are they payable?

The goals of an asset/liability study are generally fourfold:

- to inform investment policy by identifying potential investment strategies that will meet return objectives in light of the risks associated with meeting those objectives with different combinations of asset classes;
- to highlight the implications of changing benefits on asset allocation decisions;
- to assess the effect of different contribution policies on investment policy; and,
- to gain insight into other environmental conditions, such as changes in capital markets, in order to model potential future conditions of the plan.

As a rule, PERS has asset and liability studies conducted every three to five years. Callan Associates, Inc., conducted a PERS asset and liability study in June 2006. At that time, Callan took the PERS system through a seven-phase process designed to help the PERS Board select an appropriate target mix strategy that would provide it with reasonable assurance of meeting its asset goals in light of its liabilities and its risk tolerance capacity. The assumptions involved do not allow the targeting of specific return levels in a given year, but do estimate the average expected returns over a five-year period. The proposed mixes also took into account market conditions for asset classes that were varying from historical trends and the need to comply with statutory and other limiting conditions.

The overall effect of the study was to provide the PERS Board with a decisionmaking process that allowed it to focus its return expectations and requirements, profile its liabilities, establish time horizons for investment risks, define its liquidity needs, and clarify needed transition strategies and funding issues. In addition, the board was given a documented risk/reward analysis that allowed tradeoff comparisons across various asset mixes.

In 2010, Mercer conducted a Defined Benefit Asset Liability Modeling Study for PERS in two phases: the first dealt with current asset allocation and the second with alternative asset allocations. The Mercer study, much like the earlier Callan study, also sought to provide information to aid in investment decisionmaking that would have a positive affect on the plan's financial status in coming years. To do

so, it compared likely future outcomes for a number of scenarios for asset allocation that could potentially benefit the system, but that carry certain risks with their rewards. Compared to the 2006 Callan report, the 2010 report clearly reflected the greatly altered economic environment in which public pension systems now operate and the altered nature of available risk mitigation strategies, but the principles underpinning sound decisionmaking were the same.

A review of the investment strategies recommended by the PERS investment consultant and the subsequent actions of the board, as reflected in these asset/liability studies conducted every four years, confirm that the PERS Board is acting as would be expected of a public pension system with regard to investment activity. Investments conform to statutory guidelines that have been established for the system. In addition, PERS manages its portfolios with an eye to the long term, with shorter-term strategic positioning to help mitigate unexpected environmental challenges. Based on the general assumptions underlying public pension investment, PERS's current strategy has a reasonable probability of producing an appropriate rate of return and doing so within acceptable levels of risk, assuming that environmental conditions do not grossly violate expected norms.

As was true with the actuarial reviews, PEER focuses this section not on the specific recommendations of these reports, but on the fact that the PERS Board does have asset allocation and liability studies periodically conducted that inform the board's long-term investment strategy and are a continuing part of its overall risk management environment. Based on a variety of factors, including interviews with PERS staff, a reading of the PERS Board's minutes, and a review of the 2006 and 2010 asset allocation and liability studies, PEER determined that the PERS Board uses these studies to help mitigate the risks of assets not supporting liabilities. While these asset/liability studies do not guarantee that the PERS system will survive the current difficult financial environment, the fact that the PERS Board integrates the information contained in these studies into its decisionmaking process indicates that the board is actively pursuing the best course through the risks it now faces.

Asset Allocation Models

Asset class by asset class modeling allows the PERS Board to maintain a core investment focus while reacting to significant horizon events or other changes in the marketplace that call for the identification of “efficient frontiers” for investment needed to mitigate the earnings risks posed by these unexpected challenges.

Another tool the APPFA recommends from the risk mitigation toolbox is *asset allocation modeling*. Asset allocation models are generally constructed by a system’s investment staff and/or investment consultant and are approved by the board of trustees to achieve diversification among asset classes in the most appropriate way to provide the best opportunity for producing sufficient returns to meet expected liabilities.

At PERS, asset allocation modeling is not conducted on a fixed schedule, but is conducted periodically, asset class by asset class, triggered primarily by significant changes in the marketplace that might affect current earnings or that present new opportunities that might fit within the overall investment strategy. Asset allocation modeling would also be done any time there is a significant change in need, such as a change in the liquidity requirements of the fund due to an unusually high number of retirements. Asset allocation decisions are one portfolio management concern that must be alert to horizon events of any type, whether on the earnings or the liabilities side, as these horizon events may call for a modeling or review of asset allocations.

As an example, as stated in the section above on asset/liability studies, in 2010, Mercer Investment Consulting performed an asset/liability study for PERS. In a June 27, 2011, economic update, Callan Associates concluded that economic circumstances had dimmed the prospects for investment markets and that the situation called for a review of the target asset allocation from the 2010 Mercer study. Callan’s conclusion was that the plan had sufficient liquidity to allow significant investments in alternative asset classes and that such a model should be considered.

This provides an example of the potential for risk mitigation through the utilization of what is termed “efficient frontiers” for investment. The process involves the analysis and targeting of a range of risk/reward mixes that would give PERS the best opportunities to achieve its asset goals while maintaining an acceptable level of risk. Such a process is, in effect, ongoing in response to an ever-changing investment environment and in keeping with industry standards. A similar analysis was provided to the

PERS Board in Callan's June 5, 2012, economic and asset allocation report. Such activity is in keeping with the APPFA's risk mitigation recommendations.

Tools to Address Risk of Assets Not Behaving as Expected

Risks that may cause assets to not behave as expected may be external or internal.

According to the APPFA, the specific risks that may cause assets to not behave as expected may be placed into two general classes of risk: external risk and internal risk.

The primary external risks are:

- markets failing to achieve expected returns;
- legislated actions; and,
- inherent risks.

The primary internal risks are:

- strategic risks;
- poor governance;
- implementation risk; and,
- operational failure.

While PEER will not detail PERS's performance in addressing all of these types of risks, it will address PERS's actions with regard to the external risks and key elements of internal risk.

Addressing Risk: Markets Failing to Achieve Expected Returns

As is true with any investment program, whether it be public or private, public pension systems must assume some level of risk to achieve their goal of meeting their long-term benefit obligations. As noted previously, public pension systems are best described as long-term investors that employ a variety of asset allocation strategies to diversify their investments and minimize their risks over time.

As long-term investors, the risk of markets failing to achieve expected returns is not the risk that annual returns in an asset class do not perform as expected, but that the long-term behavior of one or more of these classes of investment will perform significantly differently than expected due to unforeseen circumstances (i. e., political, economic, or market). Pension systems commonly use three vehicles to address these risks:

- asset allocation reviews;
- long-term performance measurement; and,

- experience investigations (another form of periodic actuarial review).

Asset Allocation Review/Long-Term Performance Measurement

PERS uses quarterly, information-intensive asset allocation reviews that “drill down” from capital market sectors to specific investments to establish performance relative to targets and to assess the need for possible investment action. These analyses also allow for the longitudinal performance measurements that are the hallmark of a sound investment strategy for a public pension system.

PERS has *asset allocation reviews* (known to PERS as *investment measurement service quarterly reviews*) conducted on a routine, quarterly basis. These reviews are designed to show how the investment portfolio is performing relative to established targets in order to assess continually the need for possible action at the investment manager and fund performance level.

PEER found that these quarterly asset allocation reviews are produced on schedule and contain information that “drills down” from an overview of relevant capital market sectors, to asset allocation and performance data, to specific sector performance, to specific investment manager performance. Analyses are presented within relevant time frames to enable *long-term performance measurement* of the investment sector or manager’s performance. Everything tracks to the targets set by the board and to accepted comparative indices for each sector.

These quarterly asset allocation reviews are information-intensive and technical in content, covering all portfolio types and the performance of individual investment managers. However, PERS staff provide analytic and interpretive support to the board to ensure that the information is placed in a proper context for decisionmaking. While the focus is generally on the last quarter’s performance, these measures can extend to twenty or thirty years of data. In addition, the presence of “watch lists,” descriptive committee minutes, and other ad hoc management information indicate the active use of this data in management and board decisions. PEER believes that these quarterly asset allocation reviews comply with the APPFA’s views on the important elements of a comprehensive risk management process.

Experience Investigations

In addition to actuarial reviews and audits, PERS contracts for experience investigations every two years (on a rolling four-year basis) to help bring actuarial assumptions in line with actual experience, a critical corrective step in maintaining the financial soundness of any long-term investment program.

In addition to the actuarial reviews and audits discussed in the section above, PERS contracts for economic *experience investigations* covering the state's retirement systems every two years (on a rolling four-year basis). Cavanaugh Macdonald Consulting, LLC, conducted the most recent investigation for the four-year period ending June 30, 2010.

The purpose of an economic experience investigation is to assess the reasonableness of the actuarial assumptions used in the annual valuation process. This work is performed by, and under the supervision of, independent actuaries who are fully qualified by the American Academy of Actuaries to render the required opinions. In this most recent experience investigation, Cavanaugh recommended continuation of two of the three economic assumptions used in the most recent PERS actuarial valuation process: price inflation at 3.50% and wage inflation at 4.25%. Cavanaugh recommended dropping the investment return assumption from the current 8.00% to 7.50%.

These recommendations reflect Cavanaugh's best judgment of possible future outcome based on its analysis of experience and its future expectations. These assumptions are best viewed as a single point within a range established through professional judgment and informed by the purpose and nature of the investment and appropriate recent and long-term historical economic data. Cavanaugh established the reasonable range for price inflation at 2.00% to 4.00%, with what appears to be a fairly conservative recommendation set at 3.50%. Investment return is central to the annual actuarial valuation process, since it is the overall foundation for the individual asset allocation targets set by the board of trustees for investment classes and funds. Based on its projections, Cavanaugh established a reasonable range of investment return at 6.09% to 8.62% over the fifty-year projection time frame used for the analysis. Based on this projected range, Cavanaugh recommended that the PERS Board consider lowering the investment assumption from 8.00% to 7.50%. Finally, Cavanaugh projected the reasonable range for wage inflation to be between 4.00% and 5.00%, with the recommendation to retain the current assumption of 4.25%.

The purpose of PEER's presentation of these ranges and recommendations is not, at this point, to focus the reader

on the specific values and recommendations established by the independent actuaries, but to emphasize the frequency, scope, and content of the actuarial review processes the PERS Board brings to bear in its decisionmaking process. The PERS Board operates its various pension plans in a very complex and often volatile long-term economic environment. In such an environment, it is critical that decisions be made from a well-informed, long-term perspective, with a constant flow of information critical to informed decisionmaking.

In the PEER Committee's opinion, the summary of the experience investigations presented above reflects the PERS Board's due diligence in making experience investigations an important and continuing part of its overall risk management environment. Based on a variety of factors including interviews with PERS staff, a reading of PERS Board minutes, and a review of the actuarial reports themselves, PEER determined that the PERS Board uses appropriate procedures to help mitigate the risks of assets not supporting liabilities.

Addressing Risk: Legislated Actions

Any legislated actions that are taken without careful *a priori* assessment of impact may cause the system to violate its actuarial assumptions and run the risk of affecting the financial health and viability of the system. Examples would include laws that limit or prohibit ownership of certain asset types, increasing benefit formulas without concomitant available assets to fund those benefits, artificial increases in interest rate assumptions, shortages in expected contributions, or the mandating of higher investment risk to support new assumptions.

The key concern is that such actions might be taken without a full understanding of what effect the change could have on the program being funded. According to the APPFA, the outcome of such actions is likely to be trend chasing, confusion, or lack of long-term focus. Again, pension systems commonly use three vehicles to address the risks of poorly designed legislated actions:

- investment policy;
- education; and,
- legislative liaison.

Investment Policy

The wealth of investment performance information gathered quarterly by the PERS Board is used to inform an ongoing investment policy to which the board adheres. This policy provides the anchor needed to maintain a disciplined investment strategy in times of volatile markets and other environmental pressures.

The PERS Board should not allow the valuable information gained from the technical assessments of a system's assets, liabilities, and performance mentioned above to go unused. How can that goal best be accomplished?

Public retirement systems are always subject to external change and systems must take the steps necessary to minimize the likelihood that such change will adversely affect the performance of the system. A critical component in this stage of the risk management process is to ensure that the PERS Board is always acting in accord with a well-organized and documented investment policy. Acting in this manner allows the board to develop and supply the information needed to detect, and act to avoid, unsound overhauls of the system during intermittent periods of poor investment performance, while remaining open to reasonable and constructive system change.

The board adopted PERS's most recent investment policy statement updates in April 2012. The policy is reviewed every year and helps to ensure a system that will allow the board to monitor overall system performance on an ongoing basis, using agreed-upon guidelines for assessment of the need for change. This ability gives the board the information needed to counter market forces that might otherwise lead the board astray in a less disciplined environment. It also helps to assure that the board is working as a body rather than as an individually reactionary group. Standard operating procedures and a complementary education program further support the investment policy for board and staff.

The PERS Board's 2012 Investment Policy Statement specifically defines the investment objectives of the PERS system and establishes relevant policy positions, organizational structures, and a monitoring framework in order to carry out the provisions of MISS. CODE ANN. Section 25-11-121 (1972). The investment objectives are informed by an active staff presence in the investment process, high-level investment consultation, and portfolio feedback from a full range of specialized investment managers. This information-intensive environment allows the board to set appropriate investment constraints, target acceptable long-term rates of return, minimize (to the degree possible) the variability of future contributions,

diversify assets to reduce risk, and ensure adequate liquidity.

Education

The PERS Board uses an active legislative committee to analyze proposals arising from the legislative process and for perfecting proposals arising from the board as it seeks legislative adjustments that it believes will benefit or enhance all aspects of system operation.

The second commonly used vehicle that pension systems use to address the risk of poorly designed legislated actions is to educate legislators, members, and constituents regarding the possible effect of proposed actions affecting the system. In practice, this requires that an early and effective communication process be established among the various parties involved in the proposed modifications. Retirement systems can be modified, but systems that depend on long-term strategies to achieve goals are especially vulnerable to rapid change that does not allow for the sound repositioning of strategies and assets. As a consequence, early awareness, sound education, and effective communication are critical to risk avoidance when legislated actions are involved.

In assessing the PERS Board's preparedness in this area of concern, PEER notes that the PERS Board, through the actions of the staff, has been responsive to all questions posed. Within the limits of availability, PEER has been provided clear, concise information and documentation on the actions of the board, its staff, and its consulting firms in all matters relating to the board's decisionmaking process. Further, board committee minutes show the presence of an active legislative committee that provides a possible "two-way street" for analyzing proposals arising from the legislative process and for perfecting proposals arising from the board as it seeks legislative adjustments that it believes will benefit or enhance system operation. PEER's conclusion is that there is as much opportunity for both communication and education on critical topics as one might desire, but its adequacy in the decisionmaking process depends on its consistent use by all relevant parties and stakeholders.

Legislative Liaison

The Mississippi Legislature has provided legislative liaisons that are tasked with monitoring the PERS Board's activity and system operation. The value of a liaison system is to inform benefit structure decisions and other policy decisions that affect the system's funding structure.

Most public pension systems recognize the need for a monitoring and communication process that links directly

to the legislature. In Mississippi this is especially important, since it is the Legislature, not the board, that establishes the benefit structure that the board must carry out. PEER notes that the Legislature is currently represented by four legislative liaisons that are tasked with monitoring board activity and system operation (see page 13). These liaisons represent the first line of communication in matters concerning proposed legislative action.

Addressing Risks: Inherent Risks

All investments are subject to various types of risk that cannot always be avoided, but that should always be mitigated. Some of the common risks are capital risk, credit risk, inflation risk, and interest rate risks. Again, there is an accepted tool for mitigating these inherent risks that is termed asset allocation and diversification.

Asset Allocation and Diversification

The PERS Board has a detailed investment policy statement that sets the stage for comprehensive asset allocation to the fund level. The asset allocation policy also sets targets and ranges for asset classes that allow for diversification into unrelated investments.

The long-standing mitigation strategy used by most investors is diversification of investments through sound asset allocation practices. MISS. CODE ANN. Section 25-11-121 (1972) sets percentage caps for allocation of PERS’s assets within broad categories of investments (e. g., shares of stock). With regard to PERS’s asset allocation strategy, as noted earlier, the PERS Board conducts quarterly reviews of investment performance of the PERS portfolio on a manager-by-manager level. Currently, PERS reviews total fund performance on a quarterly basis, broad asset allocation is done at least every five years, manager structure is reviewed every three years, and investment policy is reviewed annually. This active monitoring of asset performance allows for ongoing rebalancing of investments. The board’s current strategic asset allocation policy calls for the following investment targets and ranges:

<u>Strategic Asset Allocation</u>	<u>Target</u>	<u>Rebalancing Ranges</u>
Public Equities	52%	+or- 4%
Private Equity	5%	+or- 5%
Real Estate	10%	+or- 7.5%
Fixed Income	27%	+or- 5%
Cash Equivalents	1%	+or- 1%

Absolute Return 5% +or- 5%

Each of these asset classes is, in turn, further stratified to allow for detailed investment monitoring and adherence to strategic goals. Benchmarks for each of these asset classes have been established as follows:

<u>Asset Class</u>	<u>Benchmark</u>
U.S. Equities	Russell 3000 Index
Non U.S. Equities	MSCI ACWI ex U.S. IMI Index
Private Equity	S&P 500 +5%
Fixed Income	BarCap Aggregate Index
Real Estate	NCREIF Property Index
Cash Equivalents	30-day U.S. T-bills
Absolute Return	8% (PERS assumed ROR)

Based on an analysis of the PERS Investment Policy Statement, PEER concludes that the current PERS asset allocation policy sets targets and ranges for asset classes that allow for diversification into unrelated investments as suggested by the APPFA report. This diversification strategy is further supported by its selection of portfolio managers to reflect a range of styles, sectors, and/or industries.

Status of Recommendations of the Public Employees' Retirement System Study Commission

As noted on page 3 of this report, on August 9, 2011, Governor Haley Barbour established the Public Employees' Retirement System Study Commission through executive order to make recommendations on improving the financial, management, and investment structure of PERS and publish such in a report to the Legislature and Governor. The study commission released *Recommendations on Ways to Strengthen the State's Retirement Plan* on December 14, 2011. The PEER Committee thought it appropriate to review the recommendations of the study commission and determine their status.

This chapter addresses:

- How was the Public Employees' Retirement System Study Commission established and why?
- What goals and subcommittees did the PERS Study Commission establish?
- What did the PERS Study Commission recommend?
- What actions have the Legislature and the PERS Board taken in response to the study commission's recommendations and why?

How was the Public Employees' Retirement System Study Commission established and why?

Amid concerns raised at the national level over the widening gap between states' assets and their obligations for public sector retirement benefits and a marked decline in the funded ratio of PERS over the last decade, Governor Haley Barbour established the Public Employees' Retirement System Study Commission by executive order to make recommendations on improving the financial, management, and investment structure of PERS in order to ensure its long-term sustainability.

On August 9, 2011, Governor Haley Barbour issued Executive Order No. 1061 creating and establishing a Public Employees' Retirement System Study Commission to make recommendations on improving the financial, management, and investment structure of PERS. The order stated that a comprehensive and thorough study of the Public Employees' Retirement System was necessary to:

- ensure the solvency and long-term sustainability of the fund;
- inform the public and current and future state employees; and,
- protect the interests of taxpayers, state employees, and retired state employees.

Executive Order No. 1061 established a twelve-member commission (including legislative members serving in an ex-officio, nonvoting capacity) appointed by the Governor and serving at his will and pleasure. (Appendix B, page 114, lists members of the study commission.) The order mandated the commission to provide a comprehensive analysis and recommendations for improving the state's retirement system to the Legislature and Governor no later than November 15, 2011.

The order noted that "Mississippi is not unique in facing pension funding issues; in fact, many states across the nation have begun to look at ways to reform their public pension funds." At the time that the order was issued, the gap between states' assets and obligations for public sector retirement benefits was widening and the public pension systems of Rhode Island and Illinois were collapsing. The funded ratio of Mississippi's PERS had dropped from having 88% of the assets needed to fund its liabilities in 2001 to having 62% in 2011.¹⁴

Also, the Governor believed that employer contributions (i.e., contributions paid by employers with covered positions on behalf of employees) were increasing at a rate that should cause concern. The Governor also expressed concern that bond rating agencies such as Moody's Investors Services and Fitch Ratings were citing PERS's increasing unfunded actuarial accrued liability as a major factor in the state's "above-average debt ratios," which could adversely affect the state's borrowing ability.

¹⁴A major factor contributing to the decline in the funded ratio of the system was increases to PERS benefits, including retroactive benefit increases (i. e., benefit increases that applied to all current and future retirees) made by the Legislature between 1999 and 2002 (refer to Appendix A on page 111) without a mechanism to fund the associated costs. These unfunded benefit expansions were followed by a period of lower than anticipated returns on investments.

What goals and subcommittees did the PERS Study Commission establish?

The PERS Study Commission established three subcommittees (Investment and Finance, Management, and Legal) to develop recommendations intended to help meet goals of increasing system funding while reducing contributions, with a particular focus on reducing employer contributions, which the commission considered an “undue burden on taxpayers.”

To help guide its work, the PERS Study Commission established the following seven goals for its “retirement policy recommendations:”

1. *Reduce the overall contributions (employer and employee) to less than 15 percent of pay¹⁵ within seven years*
2. *Eliminate as many distinctions between new hires and grandfathered employees as possible*
3. *Structure benefits consistent with a policy that does not encourage participants to stop working for the state or other participating employer prior to age 62*
4. *Increase funding to a “healthy” [status] (such as 80 percent funded status) over a seven-year period*
5. *Simplify the administration*
6. *Lower the vesting period to encourage individuals to seek public employment*
7. *Ensure best practices in all areas (financial, investment, management, etc.) are in place*

Also, the report stated that its intent was that the system “move closer towards the original ratio of employees paying 60% of the contribution and employers paying 40%, or achieve an employer-employee contribution ratio closer to 50%/50%.”

The PERS Study Commission believed that its recommendations should help to develop a plan that is “fair, affordable to both the beneficiaries and taxpayers, and sustainable in the long-term.” The PERS Study Commission further expressed its belief that it is possible to provide a meaningful and reasonable retirement benefit for members “without so large a cost to taxpayers as the current PERS system.”

While the full commission was tasked with developing general retirement policy recommendations designed to

¹⁵MISS. CODE ANN. Section 25-11-123 (1972) says “of earned compensation as defined in Section 25-11-103.”

help meet these goals, the PERS Study Commission established the following three subcommittees to make more targeted recommendations in their assigned “critical” areas of review for consideration by the full commission:

- Investment and Finance;
- Management; and,
- Legal.

What did the PERS Study Commission recommend?

The study commission recommended changes to: PERS Board membership; assumptions regarding projected investment earnings and member experience; and, PERS benefits (including the annual cost of living adjustment [COLA]). The commission also recommended further analysis of issues such as the addition of a defined contribution component to the retirement program; the appropriateness of continuing the Supplemental Legislative Retirement Plan (SLRP); and the proper division of PERS-related responsibilities between the PERS Board, staff, and the Legislature.

The PERS Study Commission released its report entitled *Recommendations on Ways to Strengthen the State’s Retirement Plan* on December 14, 2011. In his press release announcing completion of the report, Governor Barbour stated:

Neither I nor the Commission can implement any changes. It is up to the next administration and the Legislature to reform the system and ensure PERS remains solvent.

PEER presents the conclusions and recommendations of the study commission in this report for purposes of information and debate. By reporting this information, PEER is not necessarily concurring with the recommendations. See Exhibit 9, pages 84 through 94, for a complete list of the report’s twenty-three recommendations and for each recommendation, the responsible party, action taken and further discussion of such, and PEER’s position.

Appendix C, page 115, contains a discussion of the potential for closing a defined benefit pension plan and/or adding a defined contribution pension plan.

Exhibit 9: PERS Study Commission's Recommendations: Responsible Party, Action Taken, Discussion of Action/Inaction, and PEER's Position

Recommendations Adopted by the Study Commission* <i>Investment and Finance Subcommittee Recommendations</i>	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
1 Reconsider lowering investment return assumption from 8% to 7.5%	PERS Board	not adopted	<ul style="list-style-type: none"> 8% assumption is in the 75th percentile, which is still in the reasonable range as developed by PERS's actuary; real rates of return earned by investment consultants ranged from 4.07% to 5.21%; the PERS Board chose the 4.07% real rate of return to arrive at its 8% assumption; at the time the PERS Board made the decision to maintain the 8% assumption, actual performance on PERS investments for FY 2010 and FY 2011 far exceeded the 8% assumption and the long-term returns (20-year, 8.07%; 25-year, 8.38%) also exceeded the 8% assumption; the board will reevaluate the investment return assumption in conjunction with its 2013 experience investigation
PEER Position on Recommendation 1:			
PEER believes that the PERS Board exercised reasonable discretion in deciding to keep its investment return assumption at 8%. The PERS Board based this decision on careful consideration of both internal and external expert advice, as discussed on pages 103 through 104 of this report. An 8% rate of return is within the range deemed acceptable by PERS's actuary. Further, PEER notes that the board must consider multiple objectives in making its decisions--in this case, keeping contribution rates as stable as possible while assuming a reasonable rate of return on investments.			
<hr/>			
2 More regularly review investment policy to ensure strategy reflects current market conditions	PERS Board	not adopted	<ul style="list-style-type: none"> the PERS Board and investment staff already review the investment policy on a regular basis the PERS investment consultant meets with the board's Investment Committee at each meeting to provide an overview and discuss investment policy a formal asset/liability study is conducted at least every four years the PERS Board had its current investment consultant review the asset/liability study work conducted by the former consultant in 2010
PEER Position on Recommendation 2:			
PEER believes that the PERS Board has a detailed, thorough investment policy review process that occurs on a routine basis. As discussed on page 73 of this report, quarterly asset allocation reviews "drill down" from an overview of relevant market sectors, to asset allocation and performance data, to specific sector performance, to specific investment manager performance, which is then compared to targets set by the board and to accepted comparative indices for each sector. The resulting information is then translated into modifications of the board's investment policy, when necessary.			

* The PERS Study Commission did not number its recommendations. PEER added recommendation numbers for reference purposes.

** For recommendations to the PERS Board, this column explains the board's reason for action/inaction based on information provided to PEER by PERS's staff. For recommendations to the Legislature, this column discusses how the bill/resolution relates to the recommendation. Bills/resolutions that were contrary to the recommendation are noted in italics.

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>3 Continue analysis of the integration of a defined contribution feature in overall retirement program. Broaden scope of the PERS Board's Defined Contribution Committee to include a thorough review of whether Mississippi public employees would benefit from more retirement plan options; e.g., study automatic enrollment in state's 457 (b) (i. e., deferred compensation plan), a hybrid plan, or adding a separate defined contribution plan. Hire a consultant to run comprehensive analyses, including costs associated with the creation of such options.</p>	<p>Legislature and/or PERS Board</p>	<p>none by Legislature or PERS Board</p>	<ul style="list-style-type: none"> the PERS Board believes that studying the integration of a defined contribution feature in the overall retirement program is a public policy (human resource compensation) issue and therefore beyond the scope of the PERS Board of Trustees, as the Legislature, not the board, is the state's policymaking body. while the Governor's PERS Study Commission did not discuss the mechanism for funding such a study, the PERS Board noted that expending trust funds for this purpose would violate the exclusive benefit rule, a cornerstone of traditional trust law, as well as Article 14, Section 272A (1) of the State Constitution, which requires all PERS assets, proceeds or income and all contributions and payments made to PERS to provide for retirement and related benefits to be held, invested as authorized by law, or disbursed as in trust for the exclusive purpose of providing for such benefits, refunds and administrative expenses under the management of the board of trustees of the systems, and not to be encumbered for or diverted to any other purposes.
<p>PEER Position on Recommendation 3: PEER concurs with the principle of this recommendation--i.e., that it is within the fiduciary responsibility of the PERS Board to study and consider modifications to the retirement system that are allowable under law, such as modifications applicable to future covered employees. Refer to Appendix C, page 115, for a discussion of the potential impact of closing a defined benefit pension plan to new hires.</p>			
<p>Management Subcommittee Recommendations</p>			
<p>4 Authorize and provide resources for the State Auditor to conduct regular (at least every four years and any time the Legislature considers changes to plan benefits), independent reviews of PERS plan risks and performance</p>	<p>Legislature</p>	<p>none</p>	<ul style="list-style-type: none"> The FY 2013 appropriation for the Office of the State Auditor contained no authority or funding for conducting such a review.
<p>PEER Position on Recommendation 4: PEER believes that this recommendation is unnecessary because, as discussed on pages 67 through 75 of this report, PERS is already reviewed on a regular and frequent basis by multiple highly qualified firms (including auditors, actuaries, and an investment consultant) selected through a competitive process.</p>			

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>5 Consider forming permanent legislative committees to oversee PERS, with professional staff knowledgeable of actuarial science and retirement plan requirements and resources to hire independent actuaries. The commission noted that one important management issue is to assign specific responsibility for the system and creation of these committees would help to recognize the responsibility of the Legislature for the substance (versus the administration) of PERS.</p>	Legislature	none	<ul style="list-style-type: none"> No resolutions or bills related to this recommendation were introduced during the 2012 Regular Session of the Mississippi Legislature.
<p>PEER Position on Recommendation 5: While it is the Legislature's prerogative to form such committees, PEER notes that as discussed on page 77 of this report, the PERS Board has four legislative advisors who assist in management of the trust fund. Also, several legislative committees (e.g., Appropriations, Ways and Means, Finance) have subject matter jurisdiction over PERS issues and could contract for professional expertise, such as the services of an actuary, on an as-needed basis.</p>			
<p>6 Assure balanced deliberations and decision making by including the varied interests of those responsible for funding the plan through inclusion of non-participant citizens and independent directors on the PERS Board</p>	Legislature	none	<ul style="list-style-type: none"> House Concurrent Resolution 34, which died in committee, sought to set forth the current membership of the PERS Board in a new section of the Mississippi Constitution. Had this bill succeeded, it would have made it much more difficult in the future to alter the composition of the board in accordance with the recommendations of the study commission.
<p>Option 1: Add independent members with senior investment or financial management experience or extensive, senior-level private sector management experience and no direct or indirect interests in the plan.</p>			
<p>Option 2: Require the two appointed members of the PERS Board (Governor and State Treasurer) to appoint the independent members described in Option 1</p>			

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>Option 3: Form a six-member commission with authority over retirement plan design, inputs, and assumptions used by the plan actuary, with the Governor, Lieutenant Governor and/or Speaker of the House appointing three independent members as described in Option 1 and the PERS Board selecting three of its members to serve on the commission. (Plan operations, implementation, and other ministerial functions would remain under the PERS Board.)</p>			
<p>PEER Position on Recommendation 6: PEER concurs with the recommendation to include citizen members (including persons with investment or financial management expertise) on the PERS Board because, as discussed on page 23 of this report, inclusion of such members would provide for more balanced board deliberations.</p>			
<p>7 Review the need for a periodic, professional, independent risk and operational review of the PERS plan. Implement a comprehensive risk management system, compliant with framework set by Public Plans Practices Task Force of the American Academy of Actuaries. Risk factors should be listed, assessed, and published in the PERS Annual Report. External, independent auditors should review and report on the adequacy of the risk management systems. Areas of concern cited by the task force include insufficient funding by legislative bodies, excessive benefit levels in relation to the risk capacity of the plan sponsor to fund them, and inappropriate benefit designs.</p>	PERS Board	PERS has not yet completed a full analysis of this recommendation	<ul style="list-style-type: none"> The framework referenced in the report of the PERS Study Commission was a recommendation from the American Academy of Actuaries' Public Plans Practices Task Force, and to PERS's knowledge, has not yet been formally acted on by the academy. As a result, while PERS has discussed the recommendation to establish a system compliant with the framework recommended by the Public Plans Practices Task Force of the American Academy of Actuaries published in October 2010, PERS has not completed a full analysis related to this recommendation. PERS operates within a comprehensive risk management framework, delivering secure benefits to members and beneficiaries efficiently and transparently while investing and managing assets in a prudent manner. Given the various stakeholders a comprehensive risk management framework of this type would benefit (i.e., taxpayers, public employees, public sector employers, retirement system governing bodies, and legislative bodies), it is questionable whether this is a framework that should be implemented by PERS or more appropriately by the Legislature. Expanding trust funds to implement a risk management framework such as the one suggested, for which the members and beneficiaries are not the primary beneficiaries, would violate the exclusive benefit rule, a cornerstone of traditional trust law, and basic in the fiduciary obligations of a PERS Board member.

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>PEER Position on Recommendation 7: PEER believes that this recommendation is unnecessary because, as discussed on pages 59 through 79 of this report, PERS already has a strong and comprehensive risk management system that is open to the recommendations of the American Academy of Actuaries' Public Plans Practices Task Force. As discussed on page 63, PERS's contract advisors must meet rigorous standards to qualify for selection and must operate within PERS guidelines, once selected. Further, if deemed necessary, under MISS. CODE ANN. Section 25-11-101 (1972), PEER has the authority to hire an actuary to perform a random evaluation of PERS's funds and expenses.</p>			
<p>8 Repeal MISS. CODE ANN. Section 25-11-143, which requires the PERS Board to establish and fund a healthcare plan for retirees when the PERS plan reaches a certain funding level.</p>	Legislature	none	<ul style="list-style-type: none"> No bills related to this recommendation were introduced during the 2012 Regular Session of the Mississippi Legislature.
<p>PEER Position on Recommendation 8: PEER believes that the Legislature should require the State Personnel Board, Department of Finance and Administration, and State Economist to study, with necessary assistance from PERS and the Attorney General, the benefits package (e. g., compensation, retirement, leave) used as an incentive to hire and retain a quality government workforce in Mississippi. Such a study should help determine what future modifications of the retirement system, if any, might be warranted to preserve a quality government workforce and what elements should be protected, should economic conditions require significant future changes in the retirement system. The study would also provide information for policymakers to develop a more level playing field regarding total compensation of private and public sector employees who have equivalent knowledge and skill sets.</p>			
<p>9 Analyze what experts have been engaged by PERS, what their responsibilities are, how much they are paid, and what benefits and services PERS receives from these experts.</p>	unspecified	none known	Not applicable, since no known action taken
<p>PEER Position on Recommendation 9: PEER believes that this recommendation is unnecessary because, as discussed on page 61 through 66 of this report, PERS's method for acquiring and hiring expert advisors is transparent, open, and competitive.</p>			
<p>10 Review the PERS Board's authority to self-appropriate-- i.e., to pay investment manager fees, trading costs as "net investment income" (relying on an AG opinion which holds that the system is a private corporation), and advise whether the PERS Board should seek an appropriation from the Legislature to cover such costs. In FY 2010, manager's fees, trading costs and other investment-related fees amounted to \$46.6 million and PERS's administrative fees amounted to an additional \$11.7 million.</p>	Legislature	none	<ul style="list-style-type: none"> While not directly on point, HB 517, which died in conference, would have further diminished state oversight over these expenditures by exempting actuarial or investment management services contracts entered into by the PERS Board from the rules and regulations of the Personal Service Contract Review Board that govern the solicitation and selection of contractual services personnel.

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>PEER Position on Recommendation 10: PEER concurs with this recommendation. PEER has addressed this issue in at least two reports (see PEER reports #191 and #273) and maintains that PERS should seek an appropriation for all of its administrative expenditures, including investment managers' fees, trading costs, and other investment-related fees. Since PERS is a state agency and not a private corporation, it is subject to the budgetary laws of the state as well as the Legislature's constitutional authority to make appropriations.</p>			
<p>11 In light of best practices from other states, review the PERS Board's authority to impact management of the fund and determine what authority the board, executive director, or others should have to adjust benefits, COLAs, employee contributions, etc. to keep the plan adequately funded.</p>	unspecified	none known	Not applicable, since no known action taken
<p>PEER Position on Recommendation 11: While the PERS Board already has the authority under state law to establish contribution rates, PEER disagrees with a recommendation directed at allowing the PERS Board to adjust COLAs and benefits in order to keep the plan adequately funded because such adjustments as they would apply to covered retirees or current employees would violate the contractual rights of system members established in both the state and U.S. constitutions.</p>			
<p>Study Commission Retirement Policy Recommendations</p>			
<p>12 Provide that 62 would be the normal retirement age, with the following tiers for eligibility to draw retirement:</p> <ul style="list-style-type: none"> - full retirement at age 62, if vested - full retirement at age 55 with 30 or more years of service, but with no COLA until age 62, or - actuarially reduced benefit before age 55, after completing 30 years of service 	Legislature	none	No bills related to this recommendation were introduced during the 2012 Regular Session of the Mississippi Legislature.
<p>PEER Position on Recommendation 12: PEER believes that this recommendation and its potential fiscal impact should be studied for future employees only. The recommendation should not be considered for current employees because of the very high risk of litigation (and associated costs) that it carries.</p>			
<p>13 Freeze the current COLA for three years and thereafter tie the COLA to the Consumer Price Index, with a cap of 3%</p>	Legislature	none	No bills related to this recommendation were introduced during the 2012 Regular Session of the Mississippi Legislature.
<p>PEER Position on Recommendation 13: PEER believes that this recommendation and its potential fiscal impact should be studied for future employees only. The recommendation should not be considered for retirees or current employees because of the very high risk of litigation (and associated costs) that it carries.</p>			

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>14 Do not begin COLA for new retirees until 3 years after retirement</p>	Legislature	none	No bills related to this recommendation were introduced during the 2012 Regular Session of the Mississippi Legislature.
<p>PEER Position on Recommendation 14: PEER believes that this recommendation and its potential fiscal impact should be studied for future employees only. The recommendation should not be considered for retirees or current employees because of the very high risk of litigation (and associated costs) that it carries.</p>			
<p>15 Base final average compensation of a PERS retiree on four consecutive years of service based on employee's base pay. The Legislature should study whether it is appropriate to include unused leave, overtime pay, special pay, per diem and travel (in the case of legislators) as part of final average compensation.</p>	Legislature	none	<ul style="list-style-type: none"> • <i>SB 2077, which died in committee, would have expanded the definition of "earned compensation" for justices of the Supreme Court and judges of the Court of Appeals to include all remuneration amounts paid, except mileage, and would have authorized the justices and judges to claim as earned compensation all expense allowances paid to them from and after December 31, 2003, that were not previously reported as part of their earned compensation to PERS.</i>
<p>PEER Position on Recommendation 15: To the extent possible, factors adding to covered compensation for purposes of calculating an individual's PERS pension (e. g., overtime, unused leave, special pay) should be addressed by member agencies and other covered entities prior to accrual. For example, member agencies could refrain from authorizing unnecessary overtime and from granting special pay to their employees. PERS should study the fiscal impact on the system of limiting the accrual of this type of compensation.</p>			
<p>16 Consider using full-time equivalent compensation for covered members who are not full time, along with crediting partial years of service for benefit computations, but full years of service for eligibility to help PERS manage the "stacking" of salaries.</p>	Legislature	HB 517 and SB 2218 introduced and died in conference	<ul style="list-style-type: none"> • HB 517 and SB 2218, which died in conference, would have provided that creditable service (including the computation of unused leave for creditable service) be awarded in monthly increments for members of PERS for periods of time after July 1, 2013. • HB 517 and SB 2218, which died in conference, would have also made it clear that leave credit for elected officials who are members of PERS is in lieu of, and not in addition to, leave earned while simultaneously employed in a nonelected position in the system.
<p>PEER Position on Recommendation 16: PEER believes that this recommendation and its potential fiscal impact should be studied for future employees only. The recommendation should not be considered for retirees or current employees because of the very high risk of litigation (and associated costs) that it carries.</p>			

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>17 Review all statutes related to PERS and consider implications of statutes that may allow for "spiking," "stacking" of salaries (see explanatory note on the last page of this exhibit), or other manipulations within the PERS plan such as employer practices that result in inequitable costs to the PERS system--e. g., early retirement incentives.</p>	<p>Legislature</p>	<p>HB 517 and SB 2218 introduced and died in conference</p> <p>HB 1115 introduced and died in committee;</p> <p>HB 763 introduced and died in committee</p> <p>HB 1426, SB 2520, SB 2063, SB 2423, SB 2147, HB 366, and HB 925 introduced and died in committee</p>	<ul style="list-style-type: none"> • HB 517 and SB 2218, which died in conference, would have limited salary spiking for purposes of increasing PERS retirement benefits to the extent that the bills excluded from earned compensation the value of maintenance furnished after July 1, 2012, unless the member was being furnished such maintenance as of June 30, 2012, and the value of any in-kind benefits. • HB 1115, which died in committee, would have provided that the value of any maintenance furnished to PERS members that is not paid in money will not be included in the earned compensation of the members for retirement purposes. • HB 763, which died in committee, would have provided that the value of housing provided to employees of the State Department of Mental Health on the grounds of a hospital or facility under the department's jurisdiction not be included in the earned compensation of the employee for the purposes of PERS law. • All of these bills, which failed in committee, addressed the reemployment of PERS retirees who continue to receive their PERS retirement allowance (either all PERS retirees or a subset of PERS retirees such as teachers, highway safety patrol officers) by an entity covered by PERS. While the bills varied in whether they required employee and/or employer contributions to PERS for the salary earned by the PERS retiree during this period, they all prohibited the PERS retiree from earning additional creditable service during the period of reemployment. • SB 2141, which died in committee, would have expanded IHL's retirement incentive program to include participants in the optional retirement plan.

PEER Position on Recommendation 17:

In order to understand the magnitude of the costs to the PERS system associated with the practices referenced in this recommendation, PERS should study the fiscal impact of each practice on the PERS system; agencies should refrain from implementing any costly options that are under the agency's discretion. PEER does not recommend making any statutory changes that would attempt to impair the contractual rights of retirees or current employees. Any such changes should apply to new hires only.

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>18 Review employer practices that result in inequitable costs to the PERS system--e. g., early retirement incentives. Consider, among other things, an analysis of individual experience for PERS employers to determine what employers actually cost the system.</p>	unspecified	none	Neither the PERS Board nor the Legislature acted on this recommendation.
<p>PEER Position on Recommendation 18: In order to understand the magnitude of the costs to the PERS system associated with the practices referenced in this recommendation, PERS should study the fiscal impact of each practice on the PERS system; agencies should refrain from implementing any costly options that are under the agency's discretion. PEER does not recommend making any statutory changes that would attempt to impair the contractual rights of retirees or current employees. Any such changes should apply to new hires only.</p>			
<p>19 Require a fiscal note and one-year study period for legislation modifying PERS's plan design before it can be considered for enactment.</p>	Legislature	none	<ul style="list-style-type: none"> HCR 49, which died in committee, would have made it more difficult to modify PERS's plan design by requiring adoption of a new joint rule to provide that any bill, conference committee report, or concurrence in amendments adopted by the other house that adversely affects benefits or employee contribution rates for members or beneficiaries of PERS can only pass by a vote of at least two-thirds of members present and voting.
<p>PEER Position on Recommendation 19: While there are technical problems with this recommendation from a procedural standpoint, the intent of the recommendation (i. e., to study bills affecting PERS benefits prior to passage) is a good idea, given the complexity and potential ramifications of such bills (see note on page 81 concerning the role of benefit enhancements made between 1999 and 2002 on the decline in the funded status of PERS). The Legislature could effect the intended outcome by requiring that any bill that would change PERS benefits could not pass without an accompanying fiscal note that is certified as to accuracy by the PERS Board.</p>			
<p>20 Lower vesting period from 8 years to 4 years</p>	Legislature	none	No bills related to this recommendation were introduced during the 2012 Regular Session of the Mississippi Legislature.
<p>PEER Position on Recommendation 20: Provided that this recommendation is actuarially sound (i. e., that actuarial study indicates that the change would result in increased income to PERS), as claimed in the report of the PERS Study Commission, PEER believes that the Legislature should consider adopting this recommendation through legislation, since it would only apply to new hires and current employees with less than eight years of service credit who presumably would not challenge the change, since it would be an increase to their benefits under PERS.</p>			
<p>21 Conduct a transparent review of whether it is appropriate to have an additional benefit (i. e., Supplemental Legislative Retirement Plan) for members of the Legislature and the President of the Senate when these individuals are also entitled to a normal PERS benefit.</p>	Legislature	SB 2680 introduced and died in committee	<ul style="list-style-type: none"> SB 2680, which died in committee, would have mandated PERS to conduct a thorough and comprehensive study of the Supplemental Legislative Retirement Plan (SLRP) to determine the feasibility and cost of closing SLRP to new members and/or giving members the option to withdraw from SLRP and to file a report of its findings and recommendations with the Legislature by not later than December 1, 2012.

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
<p>PEER Position on Recommendation 21: As is the case with PERS, PEER believes that SLRP retirees and current members have a contractual right to their benefits; however, if the Legislature wishes to close the Supplemental Legislative Retirement Plan to future members of the Legislature, such action would probably be upheld by the courts.</p>		<p>HB 946 introduced and died in committee; HB 1113 introduced and died in committee</p>	<ul style="list-style-type: none"> • HB 946, which died in committee, would have closed the Supplemental Legislative Retirement Plan (SLRP) to new members and terminated future SLRP earnings for current members. • HB 1113, which died in committee, would have closed the Supplemental Legislative Retirement Plan (SLRP) to new members.
<p>22 Consider a more substantive funding policy for PERS, including a plan to reduce the amortization period, address a volatile investment environment, and address the allocation of risk and contributions between employer and employee.</p>	PERS Board	ongoing fiduciary responsibility of the PERS Board	<ul style="list-style-type: none"> • Given the economic environment, the impact of retroactive benefits passed beginning in 1999, and the resulting increase in contribution rates, PERS staff began discussions in the summer of 2011 relative to updating/revising the PERS funding policy. Based on a "modeling" spreadsheet developed by PERS's actuary that allowed the PERS Board to compare funding scenarios based on various assumptions regarding amortization periods, funding levels, contribution rates and projected earnings on investments, a revised funding policy was adopted by the PERS Board at its October 2012 meeting. The revised funding policy focuses on improving the long-term financial position of PERS while maintaining a stable contribution rate.
<p>PEER Position on Recommendation 22: PEER believes that PERS is already carrying out the first two components of this recommendation through its ongoing work as the system's fiduciary, as discussed on pages 44 through 58 of this report. It could be argued that the allocation of contributions between employer and employee was established at the time that an employee was hired and cannot be changed without compensating benefits, as discussed on page 29, under the California Rule.</p>			
<p>23 The PERS Actuary and PERS Board should revisit the decision to increase the wage inflation assumption (i.e., assumed future increases in salaries, which consists of an inflation component and a component for promotion and longevity) from 4% to 4.25% to determine whether the assumption should be lowered in light of the pressures on government to downsize, the reduced revenue available to pay salaries, and corresponding actions such as hiring freezes.</p>	PERS Board	not adopted, in the short run	<ul style="list-style-type: none"> • Based on the results of the actuarial experience investigation for the four-year period that ended June 30, 2010, the actuary recommended maintaining the 4.25 percent wage inflation assumption. The wage inflation assumption will be reviewed again in 2013 in conjunction with the experience investigation for the four-year period that ended June 30, 2012.

Recommendations Adopted by the Study Commission	Responsible Party	Action Taken	Further Discussion of Action/Inaction Taken**
			<ul style="list-style-type: none"> • PERS conducts actuarial experience studies every two years on a rolling four-year basis to review the assumptions used in the annual actuarial valuations of the plans administered by the board. These assumptions, including the wage inflation assumption, are compared with the experience expected under the actuarial assumptions used to determine plan liabilities and cost and revised assumptions are recommended as appropriate. • The wage inflation assumption was increased from 4.00 percent to 4.25 percent as recommended by the actuary based on the results of the experience investigation for the four-year period that ended June 30, 2008, wherein actual experience supported increasing the wage inflation assumption. Based on the results of that experience investigation, the price inflation assumption was decreased from 3.75 percent to 3.50 percent and the real wage growth was increased from .50 percent to .75 percent.
<p>PEER Position on Recommendation 23: PEER believes that the PERS Board exercised reasonable discretion in deciding to keep its wage inflation assumption at 4.25%, based on the advice of its actuary. The PERS Board bases its decisions on careful consideration of both internal and external expert advice, as discussed on pages 60 through 79 of this report.</p>			

Stacking versus spiking:
Stacking occurs when a member holds two or more positions covered by PERS and is legally allowed to use the salaries from these multiple positions in the computation of average compensation for purposes of calculating retirement benefits. An example would be a teacher who also serves on the city council or a full-time state employee who works part-time for the county.
Spiking occurs when a member's salary is artificially increased during the high-four years for the purpose of increasing the member's retirement benefits. An example would be a policeman who works excessive overtime or a state employee who is awarded unjustified salary increases during the high-four period in order to spike or increase their retirement income.

SOURCE: Public Employees' Retirement System Study Commission Report: *Recommendations on Ways to Strengthen the State's Retirement Plan* (released on December 14, 2011), information obtained from PERS staff, and PEER analysis of retirement-related bills introduced during the 2012 Regular Session of the Mississippi Legislature.

What actions have the Legislature and the PERS Board taken in response to the study commission's recommendations and why?

As of the date of this report, neither the Legislature nor the PERS Board had taken any action in response to the study commission's recommendations.

Response of the Legislature to the Study Commission's Recommendations

During its 2012 Regular Session, the Legislature did not adopt any of the PERS Study Commission's recommendations. While several bills contained elements (both supportive of and contrary to) recommendations made by the study commission, no retirement-related bill passed during the 2012 session other than PERS's appropriations bill. While no written record exists of the Legislature's deliberations with respect to the commission's report, it is possible that legislators either disagreed with the recommendations or believed that further consideration of the recommendations would be prudent prior to taking action.

By reviewing the PERS website and conducting its own search of the Legislature's website, PEER identified nineteen House bills, two House concurrent resolutions, and fourteen Senate bills related to retirement issues introduced during the 2012 Regular Session. Because the only retirement-related bill that passed was PERS's appropriations bill, it can be concluded that during its 2012 session, the Legislature did not adopt any of the PERS Study Commission's fifteen recommendations directed to it. (As noted in Exhibit 9, three of the commission's recommendations did not specify a responsible party. Neither the Legislature nor the PERS Board acted on any of these recommendations.)

Only three of the thirty-five retirement-related measures introduced during the 2012 Regular Session (i. e., SB 2680, HB 946, and HB 1113) directly related to recommendations made by the study commission. Specifically, these bills related to the study commission's recommendation for a study of the appropriateness of continuing the Supplemental Legislative Retirement Plan (see recommendation 18 on page 92). SB 2680 would have required PERS to conduct a study of SLRP to determine the feasibility and cost of closing SLRP to new members and/or giving members the option to withdraw from SLRP. HB 946 would have closed SLRP to new members and terminated future SLRP earnings for current members. HB 1113 would have only closed SLRP to new members.

As discussed in Exhibit 9, eleven other bills contained elements of the study commission's recommendations, such as HB 517 and SB 2218, which would have credited

partial years of service for benefit computations (see recommendation 16).

Only one retirement-related bill was introduced by a legislative member of the PERS Study Commission and the bill, which would have restricted PERS investments in companies with business ties in the “global security risk” countries of Iran, North Korea, Syria, and Sudan, was not a study commission recommendation.

Not only did the Legislature choose not to adopt any of the commission’s recommendations during its 2012 Session, but as noted in Exhibit 9, a few of the bills or resolutions contained language contrary to the intent of commission’s recommendations. For example, HCR 34 would have made it harder to implement the commission’s recommendation to change the composition of the PERS Board by setting forth the current composition of the board in an amendment to the state’s constitution. Further, as discussed in the next section, the Legislature did not pass legislation proposed by the PERS Board (introduced as HB 517 and SB 2218) of its own initiative designed to reduce liabilities of PERS by revising certain definitions relating to the laws governing PERS, which would have been in the spirit of what the study commission was trying to accomplish.

While no written record exists of the Legislature’s deliberations concerning the recommendations contained in the PERS Study Commission’s report, it is possible that members of the Legislature disagreed with the recommendations or that they believed that further deliberation would be prudent prior to taking action. In fact, the study commission recommended that the Legislature require a fiscal note and a one-year study period for legislation modifying PERS’s plan design before considering the legislation for enactment (see Exhibit 9, recommendation 19, page 92).

Response of the PERS Board to the Study Commission’s Recommendations

The PERS Board has not adopted any of the six study commission recommendations directed to it either because the board believed that it was already carrying out the intent of the recommendations, it did not have the authority to carry out the recommendations, or, the recommendation was not actuarially necessary to ensure the long-term sustainability of the system.

According to written responses from PERS’s Executive Director, for the following reasons the PERS Board did not adopt any of the recommendations contained in the study commission’s report because the board believed that:

- it was already carrying out the intent of the recommendation (recommendations 2, 22, and part of 7);
- it did not have the authority to carry out the recommendation (recommendation 3 and part of 7); or,
- the recommendation was not actuarially required in order to ensure the long-term sustainability of the system (recommendations 1 and 23).

(See Exhibit 9, pages 84 through 94, for additional information.)

While the PERS Board, of its own initiative pursuant to its fiduciary responsibilities (i. e., not based on the PERS Study Commission's recommendations), proposed lengthy legislative changes designed to reduce liabilities of PERS by revising certain definitions relating to the laws governing PERS (e. g., providing that creditable service for periods of time after July 1, 2013, shall be awarded in monthly increments), HB 517 and SB 2218 died in conference committee.

Conclusions

PEER intends that this report dispel as many of the rumors and as much misinformation as possible about the Public Employees' Retirement System in order to create a proper framework for policymakers to be able to identify the reforms that are needed. In this report, PEER provides key information that should be an important part of the discussion of any need for system change, such as an understanding of:

- the challenges that could constrain PERS in addressing future funding liabilities;
- the standards for judging the financial soundness and affordability of the system; and,
- whether the PERS Board has the advisory resources and information needed to address the long-term challenge of meeting its future obligations.

PEER has not attempted to second-guess decisions made by the PERS Board of Trustees, but hopes to paint a clear picture of the information environment in which the board operates and the constraints under which it must continue to operate.

This chapter is an attempt to synthesize the report's conclusions and bring forth the following key ideas:

- A sound and attractive retirement plan is an important part of state and local employment strategy. Efforts made to reform public pension systems must be made within the context of the important role of pensions in government compensation strategy.
- Enterprise thinking should continually be employed to improve the efficiency and performance of government, but such thinking must be tempered by the contractual obligations that limit what reforms may be prudently undertaken. While system changes for future employees who have yet to join the public payroll could be made with a low risk of litigation, there appears to be little, if anything, that the state could do to reduce benefits of retirees or current employees without some form of compensating new advantage.
- The financial soundness of a public pension system is more than a point-in-time comparison of assets and liabilities; it is a complex construct involving risk management strategies that help ensure that the system is always actuarially grounded, risk-informed,

and sustainable over the long term in light of all relevant environmental conditions.

- While there may always be a point at which assets, regardless of risk management expertise, simply cannot sustain the system through a prolonged economic downturn and meet the required obligations, PERS currently has risk management structures in place to help the system survive in a risk-filled marketplace and to determine when extraordinary steps are justified and must be taken. The PERS Board should be an active party in supplying policymakers with the critical information needed to make important risk-based system modification decisions.
- PERS is well organized for oversight of its investment portfolios, has access to needed investment expertise, and is supplied with the technical data needed to minimize or eliminate the risks that face a defined benefit public pension system.
- Although neither the PERS Board nor the Legislature has taken any action in response to the Public Employees' Retirement System Study Commission's recommendations, the recommendations contain elements that provide fodder for further discussion and debate.
- PERS's current financial situation is the product of a desire on the part of policymakers to improve the system's benefit structure without providing a defined source of new funding and an unprecedented drop in markets that has placed additional strain on system assets. No legislated actions should be taken regarding system modifications without careful assessment of all relevant information and of the possible impact of such modifications.

Retirement Plans and Employment Strategy

A sound and attractive retirement plan is an important part of state and local employment strategy. Efforts made to reform public pension systems must be made within the context of the important role of pensions in government compensation strategy.

PEER notes that one issue has been widely overlooked in public discussion--namely, that a sound and attractive retirement plan is an important part of state and local employment strategy. Retirement is the component of government compensation packages that is designed to attract and retain workers to a work environment where reward systems for exceptional performance are severely limited. The promise of a safe, comfortable retirement to attract the services of the best and brightest is not a trivial concern. Government is not second-class employment; it

deserves and requires individuals with skills and competencies on par with any private enterprise with which it must compete for these resources and must do so without the range of compensation incentives used effectively in the private arena.

Legal Constraints on Reform

Enterprise thinking should continually be employed to improve the efficiency and performance of government, but such thinking must be tempered by the contractual obligations that limit what reforms may be prudently undertaken. While system changes for future employees who have yet to join the public payroll could be made with a low risk of litigation, there appears to be little, if anything, that the state could do to reduce benefits of retirees or current employees without some form of compensating new advantage.

In a December 8, 2008, report entitled *Enterprise Mississippi: A Vision for State Government*, PEER pointed out the need for PERS to explore possible changes to public employees' retirement benefits (see previous PEER reports at www.peer.state.ms.us). PEER suggested such options as lowering the benefit accrual rate, modifying the fixed cost-of-living adjustment, limiting service credit for unused leave, and increasing the number of years of service required for retirement as possible subjects of study. (See Appendix A, page 111, for changes to PERS benefits.)

However, as this report shows, such proposals must also recognize certain legal limitations to change and should be accompanied with a full review of system impact, not only from the point of view of the financial impact on the retirement system, but on the impact of the change on the competitiveness of the state's overall compensation strategy.

Although historically many jurisdictions have considered retirement systems to be mere gratuities that could be modified or eliminated at the will of the employer, under Mississippi Constitution and law, the state is contractually obligated to provide retirement benefits to retirees and to current employees who are in PERS-covered positions, but it is not restricted as to what benefits must be provided to future employees.

Retirement benefits that were in effect at the time of employment are generally immune to modification except through mutual consent. In cases wherein some state action diminishes a benefit provided to PERS members, mutual consent is not assumed unless there is a compensating new advantage to offset the loss. If not, the employee has a contractual right to the more favorable benefit and may choose to sue to obtain it.

PEER notes that there appear to be at least three other restricted conditions under which abrogation of benefits to public employees and retirees have been suggested as a legally viable option: when the action is necessary to protect the retirement system in the face of an “imminent collapse,” when the current condition was unforeseeable and thus not avoidable, or when poor market performance suggests the need to modify current benefits to ensure the future viability of the system. PEER concludes in this report that the PERS system does not face imminent collapse, policymakers were given adequate notice and opportunity to mitigate the fiscal effects of benefit changes that significantly contributed to current financial standing, and long-term market performance goals are still attainable within acceptable risk boundaries. Given these conditions and the risks of incurring significant legal challenges, PEER does not believe that PERS’s current financial condition supports any of these three arguments as a basis for change through contract abrogation.

While further study of the state’s policy position on affordability of the system may be in order, such discussions must include an analysis of both the costs and benefits of maintaining an effective retirement program, including the costs of eliminating or “phasing out” the current system in the most cost-effective manner possible, if that is deemed a cost-beneficial strategy.

Financial Soundness and Affordability

The financial soundness of a public pension system is more than a point-in-time comparison of assets and liabilities; it is a complex construct involving risk management strategies that help ensure that the system is always actuarially grounded, risk-informed, and sustainable over the long-term in light of all relevant environmental conditions.

In thinking about the health of a public pension system, “financial soundness” is a more complex construct than it at first appears. The judgment of financial soundness should not be based solely on an arbitrarily restricted view of earnings relative to liabilities, as is the case when one relies on a system’s unfunded actuarial accrued liability as a single point-in-time look at a system’s health without understanding the longer-term conditions that can significantly inform the decisionmaking process. While the UAAL is an important indicator of possible system health, for any public pension system to be judged financially sound, it must not only be actuarially grounded, but also be risk-informed and sustainable over the long-term. PEER concurs with PERS’s contention that a sound system is one that keeps a watchful eye on any risks that threaten application of the following formula and acts to eliminate or mitigate those risks:

Contributions + Investment Income = Benefits + Expenses

PEER concludes that the term “financial soundness” should be defined as a multi-faceted construct involving an understanding of the role of actuarial soundness in judging financial health, a broadly defined view of affordability that encompasses sustainability in light of all relevant environmental conditions, and an understanding of the role of risk management in the long-term financial health of the system. The marketplace can sink any system--PERS included--but the public policy concern is whether PERS is structured to survive adverse markets where possible and to advise policymakers when adjustments to the system are sorely required.

With this perspective in mind, PEER offers the following regarding PERS’s ability to re-establish public confidence in its ability to monitor and sustain the long-term health of the system.

- The PERS Board is using the concept of actuarial soundness in a proper context to inform its investment policy and evaluate its ongoing performance relative to its liabilities. PEER views the board’s current use of actuarial soundness in its decisionmaking process as a necessary, but not a sufficient, condition to ensuring the long-term financial soundness of the system.
- While recent and expected increases in contribution rates challenge the general view of affordability, considered within the context of the potential cost of abrogating current contractual obligations and the front-end costs of closing or phasing out the current system, contribution rates are sustainable and are critical to maintaining the financial soundness of the system. This does not preclude considering system adjustments for future employees, administratively stopping adverse employment practices before they happen (e. g., “spiking” and “stacking”¹⁶), considering conversion to monthly payment of the COLA, or other actions that would not abrogate contracts, but that might help to reduce the liability pressures of the system.

¹⁶*Stacking* occurs when a member holds two or more positions covered by PERS and is legally allowed to use the salaries from these multiple positions in the computation of average compensation for purposes of calculating retirement benefits. An example would be a teacher who also serves on the city council or a full-time state employee who works part-time for the county. *Spiking* occurs when a member’s salary is artificially increased during the “high-four” years for the purpose of increasing the member’s retirement benefits. An example would be a policeman who works excessive overtime or a state employee who is awarded unjustified salary increases during the “high-four” period in order to spike or increase retirement income.

- PERS is well organized for oversight of its investment portfolios, has access to needed investment expertise, and is supplied with the technical data needed to minimize or eliminate the risks that face a defined benefit public pension system.
- The PERS Board, as a part of its fiduciary responsibility to ensure the sustainability of the system, should, through its legislative liaisons, identify opportunities such as those listed above and provide an open dialogue on change. The need for continued open dialogue also highlights the importance of a government being proactive in such matters. Future decisions regarding benefit structures should be made after being fully informed, because once made, such promises are extremely hard to break.

Risk Management

While there may always be a point at which assets, regardless of risk management expertise, simply cannot sustain the system through a prolonged economic downturn and meet the required obligations, PERS currently has risk management structures in place to help the system survive in a risk-filled marketplace and to determine when extraordinary steps are justified and must be taken. The PERS Board should be an active party in supplying policymakers with the critical information needed to make important risk-based system modification decisions.

A financially sound public pension system is one that is structured and operated to manage its long-term risk environment in ways that allow it a reasonable opportunity to collect or earn sufficient assets to meet its benefit obligations.

In analyzing PERS's ability to manage risk, PEER concludes that, while there may always be a point at which assets, regardless of risk management expertise, simply cannot sustain the system through a prolonged economic downturn and meet the required obligations, PERS currently has risk management structures in place to help the system survive in a risk-filled marketplace and to determine when extraordinary steps are justified and must be taken.

In reaching this conclusion, PEER acknowledges that PERS's unfunded actuarial accrued liability has dropped to fifty-eight percent and may drop further. While this is a matter of concern and should be carefully monitored, it is not necessarily a death knell. A pension system's funding level should be viewed over several years to determine trends and evaluated in the context of economic conditions existing during that time. As economic conditions fluctuate, the funding level of a pension system will fluctuate accordingly. Decisions regarding a pension

system should not be based on one particular year's funding level or amount of change from the previous year.

During the last ten years, PERS's investment return on assets averaged 6.20%, as opposed to the targeted return of 8%. Investment returns ranged from -19.4% during FY 2009 to 25.4% during FY 2011. Historically, PERS's investment returns have averaged 7.41% during the last twenty years and 9.63% over the last thirty years. The volatility of the recent years' returns reinforces the principle of viewing investment returns over long period of time and comparing long-term returns to investment return goals.

PERS is at a low point in this cycle, but it still has an actuarially sound path to follow. It begins with fully funding the actuarial required contribution, a step that is critically important in that it allows the system to keep pace with a plan's normal cost (i. e., the cost of benefits accrued in a fiscal year) and to pay toward the amortized cost of any unfunded liability based. While this path to recovery is costly on its face--an employer contribution rate of 14.26% with a proposal to go to at least 15.75% and an employee contribution rate of 9.00%--it does hold promise for stabilizing and recovering the unfunded liabilities the system has incurred and for providing a climate for rational systemic reform at an appropriate pace and using appropriate strategies.

PEER also concludes that the PERS Board should be an active party in supplying policymakers with the critical information needed to make important risk-based system modification decisions. Just as PERS makes investment decisions based on the best risk data available, the Legislature must be provided with the sound risk-based information needed to guide system reform policy when conditions indicate that reform is a necessity. While the PERS Board's primary fiduciary responsibility is to the current participants, when conditions indicate the sustainability of the system is sorely in question from a cost/benefit perspective, the PERS Board must be a part of its identification and a modeling of possible solutions.

Investment Management

PERS is well organized for oversight of its investment portfolios, has access to needed investment expertise, and is supplied with the technical data needed to minimize or eliminate the risks that face a defined benefit public pension system.

Public pension systems use adherence to an asset allocation strategy over long periods to ride out fluctuations in financial markets. PEER concludes that the PERS Board has adopted and implemented policies and procedures that allow it to address the common investment risks faced by all public pension systems, thus

enabling it to carry out its fiduciary responsibilities to its active members, inactive members, and retirees.

PEER concludes that PERS is well organized for oversight of its investment portfolios, has access to needed investment expertise, and is supplied with the technical data needed to minimize or eliminate the risks that face a defined benefit public pension system. Evidence gleaned from available actuarial assessments, investment reports, and PERS Board's minutes and publications shows that the board has acted prudently on available information and has responded within acceptable limits to minimize key risks as they have emerged.

PERS staff provide analytic and interpretive support to the board to ensure that the information is placed in a proper context for decisionmaking. In addition, the presence of "watch lists," descriptive committee minutes, and other ad hoc management information indicate the active use of this data in management and board decisions.

Status of Public Employees' Retirement System Study Commission

Recommendations

Although neither the PERS Board nor the Legislature has taken any action in response to the study commission's recommendations, the recommendations contain elements that provide fodder for further discussion and debate.

Although PEER does not believe that the PERS system is in imminent threat of a collapse, it is in a critical period where conscientious monitoring, constructive dialogue, and careful debate of options is absolutely essential to the future of the program. The PEER Committee believes that dialogue may best begin with an assessment of the status of recommendations that have already been proposed for system modification. The most obvious starting point for that discussion would be the recommendations of the Public Employees' Retirement System Study Commission.

The PERS Study Commission developed recommendations intended to help meet goals of increasing system funding while reducing contributions, with a particular focus on reducing employer contributions, which the commission considered an "undue burden on taxpayers." Guiding its work were seven goals that, while PEER concludes are responsive to concerns over growing employer contribution rates, are not all reasonably achievable without incurring the likely consequences of breach of contract and costs of closure that would increase, not reduce, the immediate funding requirements of the system.

The study commission recommended changes to PERS Board membership; assumptions regarding projected

investment earnings and member experience; and, PERS benefits (including the annual cost of living adjustment [COLA]). The commission also recommended further analysis of issues such as the addition of a defined contribution component to the retirement program; the appropriateness of continuing the Supplemental Legislative Retirement Plan (SLRP); and the proper division of PERS-related responsibilities among the PERS Board, staff, and the Legislature.

The PERS Board did not adopt any of the six study commission recommendations directed to it either because the board believed that it was already carrying out the intent of the recommendations, it did not have the authority to carry out the recommendations, or the recommendation was not actuarially necessary to ensure the long-term sustainability of the system. While the PERS Board, of its own initiative, proposed lengthy legislative changes designed to reduce liabilities of PERS by revising certain definitions relating to the laws governing PERS, those proposed changes died in committee, as did other PERS-related legislation.

PEER concludes that, while the commission's recommendations contain elements that provide fodder for further discussion, PERS's specific decisions regarding investments and earnings were within specified bounds, were in keeping with its investment policies, and are still subject to revision as it believes advice and data indicate. Other issues, such as a defined contribution component and the continued existence of systems, are subject to further debate for future employees, while board composition and the proper division of responsibilities are always on the table for discussion.

Implications for Change

PERS's current financial situation is the product of a desire on the part of policymakers to improve the system's benefit structure without providing a defined source of new funding and an unprecedented drop in markets that has placed additional strain on system assets. No legislated actions should be taken regarding system modifications without careful assessment of all relevant information and of the possible impact of such modifications.

Based on the depth and breadth of information available, PEER must conclude that PERS's current financial situation is the product of a desire on the part of policymakers to improve the system's benefit structure without providing a defined source of new funding and an unprecedented drop in markets that has placed additional strain on system assets.

PEER notes that no legislated actions should be taken regarding system modifications without careful assessment of all relevant information and of the possible

impact of such modifications. Failure to do so could cause the system to violate its actuarial assumptions and run the risk of further affecting its financial health and viability. Examples would include laws that limit or prohibit ownership of certain asset types, increasing benefit formulas without concomitant available assets to fund those benefits, artificial increases in interest rate assumptions, shortages in expected contributions, or the mandating of higher investment risk to support new assumptions.

The current PERS Board has acted in accord with a well-organized and documented investment policy to develop and supply the information needed to detect, and act to avoid, unsound overhauls of the system during intermittent periods of poor investment performance, while remaining open to reasonable and constructive system change. The board reviews investment policy every year and monitors overall system performance on an ongoing basis, using agreed-upon guidelines for assessment of the need for change. This ability gives the board the information needed to counter market forces that might otherwise lead the board astray in a less disciplined environment. It also helps to assure that the board is working as a body rather than as an individually reactionary group.

In addition, the PERS Board has direct access to a legislative advisory subcommittee to analyze proposals arising from the legislative process and for perfecting proposals arising from the board as it seeks legislative adjustments that it believes will benefit or enhance all aspects of system operation.

PERS's primary weapon in conveying its standing in this complex and ever-changing financial arena is information. It has access to the needed information; its challenge is to use that information effectively to educate legislators, members, and constituents regarding the possible effect of proposed actions affecting the system.

It is PEER's observation that PERS currently maintains an oversight environment that is capable of seeing the system through difficult economic times, while acknowledging that extreme economic conditions can overpower even the best-run systems. In addition, while the system can and should be subject to ongoing needs assessment and possible change, such change must come with a careful eye to the total cost/benefit picture and to the needs of all stakeholders.

Recommendations

1. While PEER acknowledges the seriousness of the funding concerns facing PERS, the Committee believes PERS's current financial condition is sufficiently sound to make any modification of current employees' and retirees' benefits legally inadvisable. Therefore, the Legislature should carefully consider PERS's October 2012 proposal for achieving an 80% funded ratio by 2042 (see page 42) as a reasonable course of action for long-term stability.
2. In preparation for an uncertain future, the Legislature should require the State Personnel Board, Department of Finance and Administration, and State Economist to study, with necessary assistance from PERS and the Attorney General, the benefits package (e. g., compensation, retirement, leave) used as an incentive to hire and retain a quality government workforce in Mississippi.

Such a study should help determine what future modifications of the retirement system, if any, might be warranted to preserve a quality government workforce and what elements should be protected should economic conditions require significant future changes in the retirement system. The study would also provide information for policymakers to develop a more level playing field regarding total compensation of private and public sector employees who have equivalent knowledge and skill sets.

3. The PERS Board of Trustees should develop and maintain an ongoing assessment, catalog, and prioritization of possible PERS reform options that would be available to the Legislature should it request such.
4. In further acknowledgment of the largely uncharted economic course that the state and the PERS system now face, the Legislature should amend MISS. CODE ANN. Section 25-11-15 (1972) to require the PERS Board of Trustees to work with the legislative liaisons, the Attorney General, actuaries, and investment advisors to establish the elements of a risk assessment strategy that would provide both the PERS Board and the Legislature with a working definition of "imminent collapse," along with the information needed to make early identification of any threat of imminent collapse of the system. Such information would allow the Legislature to modify

the benefit structure of the system for all participants based on risk, priority, and impact, should economic conditions force such change to become the only option for protecting the viability of the system.

5. The Legislature should require the PERS Board of Trustees to work with relevant control agencies or associations of state and local government to survey participating employers to determine compensation practices (e. g., “stacking,” “spiking”) that could create an excessive liability for the system. By January 1, 2014, the board should provide to the Legislature recommendations to address such practices administratively or statutorily.
6. While PEER finds no improper actions on the part of the current PERS Board, to improve the public’s confidence regarding the objectivity of the board in making decisions that affect the system, the Legislature should amend MISS. CODE ANN. Section 25-11-15 (1972) to revise the board’s composition as follows:
 - change one of the two system member positions provided for in subsection (c) (i. e., state employee members) and one of the two positions of a member receiving a retirement allowance as provided for in subsection (f) (i. e., retiree members); and,
 - replace these two members with individuals who are not members or retirees of the system, one appointed by the Governor and one appointed by the Lieutenant Governor. In making such appointments, the Governor and Lieutenant Governor should give preference to individuals with expertise in investments or financial management.

Also, the Legislature should amend subsection (b) of MISS. CODE ANN. Section 25-11-15 (1972) to state that in making this appointment (i. e., the gubernatorial appointment currently required by law), the Governor should give preference to an individual with expertise in investments or financial management.

7. As addressed by PEER in at least two previous reports (see PEER reports #191 and #273 at www.peer.state.ms.us), PERS should seek an appropriation for all of its administrative expenditures, including investment managers’ fees, trading costs, and other investment-related fees. Since PERS is a state agency and not a private corporation, it is subject to the budgetary laws of

the state as well as to the Legislature's constitutional authority to make appropriations.

Appendix A: Description of Changes to PERS Benefits Made by the Legislature from 1999-2012, by Effective Date and MISSISSIPPI CODE Section

Effective Date	MISSISSIPPI CODE Section	Description of Change to PERS Benefits
<i>Benefit Enhancements</i>		
7/1/1999	25-11-111	Increased benefit accrual from 2.00% to 2.25% for all years of service over 25 for current and future retirees
	25-11-112	Increased base COLA from CPI-based, ¹⁷ not to exceed 2.50% annually, to fixed 3% simple up to age 55 and 3% compounded after age 55; removed discretionary COLA based on investment earnings
	25-11-112	Based reemployed retiree COLA on all fiscal years in retirement, not just the fiscal years in retirement since the last retirement
	25-11-112	Provided that the COLA will be prorated and paid to the beneficiary of a retiree or beneficiary who is receiving the COLA in a lump sum and who dies between July 1 and December 1
7/1/2000	25-11-111	Increased benefit accrual from 1.875% to 2.00% for all years of service over 10 and less than 25 for current and future retirees
7/1/2001	25-11-111	Increased benefit accrual from 1.875% to 2.00% for all years of service over 5 and less than 25 for current and future retirees
7/1/2002	25-11-111	Increased benefit accrual from 1.875% to 2.00% for all years of service up to and including 25 and from 2.25% to 2.50% for all years of service over 25 for current and future retirees
	25-11-103(f) and (k)	Increased maximum compensation cap from \$125,000 to \$150,000
	25-11-109(6)	Provided creditable service at no cost for active duty military service for pre-1972 service in the Commissioned Corps of the United States Public Health Service for those retiring on or after July 1, 2002
	25-11-112	Provided that a reemployed retiree who has previously been retired for at least one full fiscal year no longer has to wait another full fiscal year for his or her COLA to resume
	25-11-127	Provided that a local county or municipal elected official who is receiving retirement benefits may receive a salary for the elected position that does not exceed 25% of the retiree's average compensation

¹⁷CPI=Consumer Price Index

	25-11-143 and 25-11-145	Authorized the establishment of a Retiree Health Insurance Plan to cover all retirees of plans administered by PERS.
7/1/2004	25-11-114	Removed remarriage penalties from certain spouse survivor benefits
7/1/2008	25-11-103(f) and (k)	Increased maximum compensation cap from \$150,000 to coincide with Internal Revenue Service limits. Initially, this change increased the earned compensation limit from \$150,000 to \$230,000 effective July 1, 2008. Since then, the limit has increased from \$230,000 to \$250,000.
7/1/2010	25-11-109	Provided that members who retire on or after July 1, 2010, receive additional credit toward retirement for one-half day of leave for each full fiscal year of membership service accrued after June 30, 2010
	25-11-115	Made Option 4, a 75% joint and survivor annuity, available to members who retire on or after January 1, 2011
<i>Benefit Reductions</i>		
7/1/2007	25-11-105	Increased vesting period from 4 years to 8 years
7/1/2010	25-11-123	Increased the employee contribution rate from 7.25% to 9.00% of earned compensation
	25-11-127	Tightened regulations on “double dipping” into the PERS plan by (1) requiring local elected officials to be age 62 or older to retire and continue in office without a break in service; and (2) requiring employers to pay employer contributions on the full salary in effect for the position for any retired member who is reemployed as a local elected position in what would otherwise be a covered position
7/1/2011	25-11-127	Tightened regulations on “double dipping” into the PERS plan by (1) establishing a required separation period of not less than 90 days before a retiree may be reemployed on a limited basis; and (2) requiring employers to pay employer contributions on compensation paid to retirees working on a limited basis while receiving a retirement allowance
	25-11-111	Increased the number of years of creditable service required for service-based retirement from 25 years to 30 years for new employees hired on or after July 1, 2011
	25-11-111	Reduced benefits for those retiring at age 60 with less than 30 years of service for new employees hired on or after July 1, 2011
	25-11-111	Moved the 2.5% retirement multiplier out to 30 years from 25 years for new employees hired on or after July 1, 2011
	25-11-112	Moved the 3% compound COLA rate from age 55 to age 60 for new employees hired on or after July 1, 2011

7/1/2012	25-11-115	Provided that calculation of all optional benefits will be cost neutral to the plan
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SOURCE: Based on information provided by PERS staff.

Appendix B: Members of the Public Employees' Retirement System Study Commission, 2011

Member	Professional Credentials Noted in the Commission's Report*
George Schloegel, Chairman	Retired Hancock Bank Chief Executive Officer and Gulfport Mayor
Will Flatt	Parkway Properties
Reuben Anderson	former Supreme Court Justice
Harry Walker	Trustmark Bank
Seale Pylate	Phelps Dunbar
Bill Crawford	former legislator, PERS retiree, and president of The Montgomery Institute
Bill Benson	Lee County Chancery Clerk and current chairman of the PERS Board of Trustees
Kevin Upchurch	Director, Department of Finance and Administration
Senator Hob Bryan**	Legislator
Senator Dean Kirby**	Legislator
Representative Preston Sullivan**	Legislator
Representative Greg Snowden**	Legislator

* These credentials are presented exactly as they were listed in the commission member section of the PERS Study Commission's report. In some cases, the report stated the commission member's title or position and in some cases it did not.

**Denotes non-voting members

SOURCE: Report of the Public Employees' Retirement System Study Commission, *Recommendations on Ways to Strengthen the State's Retirement Plan*, released December 14, 2011.

Appendix C: Potential Impact of Closing a Defined Benefit Pension Plan to New Hires

While closure of a defined benefit plan might appeal to those seeking to reduce the costs of public pension plans to the taxpayer, such action could actually result in increased taxpayer costs--both short-term and long-term--and could negatively impact the state's ability to attract and retain a highly qualified workforce.

According to a December 2011 review of retirement benefits issued by Virginia's Joint Legislative Audit and Review Commission (JLARC), while many states, including Virginia, have recently studied closing their defined benefit plans as a strategy to reduce public sector retirement plan costs, none of the states included in the review had taken this action because "the near-term costs associated with this approach were found to be unmanageable."

As will be discussed in the following sections, among the costs associated with closure of a defined benefit plan are the increased public expenditures necessary to fund the defined benefit plan during the close-out period and the possible long-term costs of providing financial assistance to defined contribution plan participants in their retirement years if their income from a defined contribution plan is insufficient to meet a subsistence level cost of living.

Also, as noted previously in this report, major system changes (such as closing the current defined benefit plan) could make public employment less attractive and could negatively affect the state's ability to attract and retain a highly qualified workforce.

Approaches Typically Considered for Closing a Defined Benefit Plan

One approach to closing a defined benefit plan is to close the plan to new members and phase the plan out over time as current members retire and exhaust their benefits.

According to a briefing on the actuarial impact of closing a retirement plan made by Brian Murphy of the consulting and actuarial firm of Gabriel, Roeder, Smith & Company at the 2011 Annual Meeting of the National Council on Teacher Retirement, "closing" a defined benefit plan such as PERS could be executed in a variety of ways, including the following :

- requiring new hires to participate in an alternative plan such as a defined contribution plan and requiring current employees to participate in the other plan for future service **or** allowing current employees to choose

whether to participate in the other plan for future service;

- allowing both new hires and current employees, through voluntary arrangements, to choose among a defined benefit plan, a defined contribution plan, or a hybrid plan.

Under the first option, the defined benefit plan is closed to new hires. The second option does not really close the defined benefit plan, since participation in the alternative plan or plans is optional.

According to a 2011 article¹⁸ published by the Center for Retirement Research at Boston College, while defined contribution plans have a role in the public sector, “that role is supplementing, not replacing, defined benefit plans.”

According to the article, while twelve states included a defined contribution plan in their state’s retirement system as of April 2011, at the time of the study only two of those states, Alaska and Michigan, required all new hires to participate solely in a defined contribution plan. Four of the states with a defined contribution plan (Oregon, Utah, Indiana, and Georgia) required members to participate in a hybrid plan (i. e., one that combines a defined benefit plan with a defined contribution plan). Six states with a defined contribution plan (Washington, Montana, Colorado, Ohio, South Carolina, and Florida) offered members a choice of their primary plan.

Costs of Closing a Defined Benefit Plan

Rather than creating taxpayer savings, the near-term costs of closing a defined benefit plan are substantial and it is possible that the long-term costs of closing such a plan could also erase any potential savings from the conversion.

While advocates of defined benefit plan closure believe such actions will reduce the costs of public pension plans to the taxpayer, they may not realize that such an action actually increases costs, at least in the short term and quite possibly in the long term.

If a state chooses to close its defined benefit plan by requiring all new hires to participate in a defined contribution plan, several factors work to increase the funding needs of the ongoing defined benefit plan for current employees and retirees:

¹⁸A *Role for Defined Contribution Plans in the Public Sector* by Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz, and Laura Quinby, published in *State and Local Pension Plans*, Number 16, April 2011.

- *Annual funding requirements increase:* In the event of a defined benefit plan closure, accounting rules require that the amortization period of the defined benefit plan change from a rolling period to a fixed period, which accelerates the defined benefit plan's amortization schedule.
- *Income from contributions decreases:* The assets accumulated (contributions and investment earnings) from the new hires participating in the defined contribution plan are no longer funding the ongoing liabilities of the defined benefit plan.
- *Income from investments decreases:* As the payroll base from which to draw contributions to support the continuing defined benefit plan liability diminishes, the defined benefit plan's investment strategy must change to meet increasing liquidity requirements--i. e., the need to sell assets to meet continuing benefit payments under the defined benefit plan that is being phased out. A more liquid portfolio likely results in allocating investments among investments with lower expected returns.

To compensate for these funding pressures, the actuary for the Virginia Retirement System estimated that in the first year of conversion to a defined contribution plan, contribution rates for the state employees' defined benefit plan would have to *increase* by more than 10% of payroll. Virginia's Joint Legislative Audit and Review Commission estimated that the additional costs of converting its state employees' and teachers' defined benefit plans to defined contribution plans for new hires would be \$331 million to \$340 million in the first year alone.

In addition to the short-term costs associated with converting to a defined contribution plan, Brian Murphy noted that such a conversion can also create long-term costs. For example, retirees participating in a defined contribution plan may, in some cases, become eligible for and receive public assistance at a cost to both federal and state governments. Further, if pensions resulting from defined contribution plans prove to be inadequate, state governments may have to make up the difference and any savings that might have been realized through closure of the defined benefit plan could quickly disappear.

Mr. Murphy also noted that defined contribution plans have higher administrative costs than defined benefit plans. Further, during any transition period, the retirement system administrator must bear the additional expense of administering multiple benefit provisions.

SOURCES: *Review of Retirement Benefits for State and Local Government Employees*, Joint Legislative Audit and Review Commission, December 2011; presentation by Brian B. Murphy of Gabriel Roeder Smith & Company on October 10, 2011; *A Role for Defined Contribution Plans in the Public Sector* by Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz, and Laura Quinby.



December 3, 2012

Max K. Arinder, Ph.D.
Executive Director
Performance Evaluation and Expenditure Review
Woolfolk Building, Suite 301-A
501 North West St.
Jackson, MS 39201

Dear Dr. Arinder:

Thank you for the opportunity to review the draft of the PEER Report titled The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness. We acknowledge and appreciate the extensive effort expended by you and your staff in compiling this very thorough report. We will briefly respond to each of the seven recommendations listed at the end of the report.

- 1. While PEER acknowledges the seriousness of the funding concerns facing PERS, the Committee believes PERS's current financial condition is sufficiently sound to make any modification of current employees' and retirees' benefits legally inadvisable. Therefore, the Legislature should carefully consider PERS's October 2012 proposal for achieving an 80% funded ratio by 2042...as a reasonable course of action for long-term stability.

PERS Response to Recommendation 1:

After nearly a year of study and with guidance from its actuary, the Public Employees' Retirement System of Mississippi (PERS) Board of Trustees, based on today's assumptions and projections, revised its funding policy to set a goal of reaching a minimum funded ratio of 80 percent by 2042. Under this revised policy, the employer contribution rate will no longer be established annually based on a rolling 30-year amortization period. Instead, the focus will be on the long-term funded status of the plan with an additional goal of stabilizing the contribution rate.

The funding policy components will be reviewed annually following the annual actuarial valuation and in conjunction with the annual projection report and will be amended as necessary following each experience investigation conducted by the Board.

Table with 7 columns: Name, Title, and six Board of Trustees members (Lee Childress, Virgil F. Belue, Bill Benson, Lynn Fitch, Cecil Hill, Tom Lariviere, Ed LeGrand, H.S. "Butch" McMillan, Richard C. Miller, Jack Wilson) with their respective titles.

- In preparation for an uncertain future, the Legislature should require the State Personnel Board, Department of Finance and Administration, and State Economist to study, with necessary assistance from PERS and the Attorney General, the benefits package (e.g., compensation, retirement, leave) used as an incentive to hire and retain a quality government workforce in Mississippi.*

Such a study should help determine what future modifications of the retirement system, if any, might be warranted to preserve a quality government workforce and what elements should be protected, should economic conditions require significant future changes in the retirement system. The study would also provide information for policymakers to develop a more level playing field regarding total compensation of private and public sector employees who have equivalent knowledge and skill sets.

PERS Response to Recommendation 2:

PERS has consistently held that retirement benefits should be evaluated in the context of the overall compensation package. However, in undertaking a review of possible changes to the retirement benefits offered to public employees, representatives from all participating employer groups should be included. This would necessarily include representatives from state agencies, state universities, public schools and community/junior colleges, cities, and counties. In addition, rather than working in isolation, we suggest that PERS be included as a part of the proposed study group to ensure the full impact of any recommendations regarding future modifications of the retirement system are thoroughly vetted.

- The PERS Board of Trustees should develop and maintain an ongoing assessment, catalog, and prioritization of possible PERS reform options that would be available to the Legislature should it request such.*

PERS Response to Recommendation 3:

PERS routinely conducts assessments and has a long history of bringing forward proposed legislative changes in the form of technical amendments to the retirement laws. PERS regularly evaluates legislative proposals for the potential cost impact to PERS and provides this information to the legislative leadership.

- In further acknowledgement of the largely uncharted economic course that the state and the PERS system now face, the Legislature should amend MISS. CODE ANN. Section 25-11-15 (1972) to require the PERS Board of Trustees to work with the legislative liaisons, the Attorney General, actuaries, and investment advisors to establish the elements of a risk assessment strategy that would provide both the PERS Board and the Legislature with a working definition of “imminent collapse,” along with the information needed to make early identification of any threat of imminent collapse of the system. Such information would allow the Legislature to modify the benefit structure of the system for all participants based on risk, priority, and impact, should economic conditions force such change to become the only option for protecting the viability of the system.*

PERS Response to Recommendation 4:

PERS acknowledges the merits of this recommendation; however, we do not believe amending the statute is required to accomplish this objective. With necessary assistance from its various advisors, the Board could incorporate a working definition of “imminent collapse” into its funding policy. The Board could begin that process in 2013 by first surveying other states to see how they have defined imminent collapse and then develop a definition appropriate for Mississippi. Another potential next step in this process could be to identify and document within the Board’s funding policy possible modifications to the benefit structure that might serve to protect the fund against the threat of imminent collapse.

5. *The Legislature should require the PERS Board of Trustees to work with relevant control agencies or associations of state and local government to survey participating employers to determine compensation practices (e.g., “stacking,” “spiking”) that could create an excessive liability for the system. By January 1, 2014, the board should provide to the Legislature recommendations to address such practices administratively or statutorily.*

PERS Response to Recommendation 5:

In 2011, PERS adopted Board Regulation 65, *Earned Compensation for the Public Employees’ Retirement System of Mississippi*, in an effort to clearly define “earned compensation” for its participating employers and members.

In 2012, the Board attempted to further clarify and limit the definition of “earned compensation” by proposing amendments to Miss. Code Ann. § 25-11-103(k) to (1) prospectively exclude the value of maintenance from earned compensation; (2) clarify that employer-paid health and life insurance premiums for an employee are not earned compensation, whether taxable or nontaxable to the employee; (3) prospectively exclude performance-based incentive payments from earned compensation; and (4) clarify that in-kind benefits are not reportable as earned compensation.

The Board will likely carry-forward the above proposed amendments for legislative consideration in 2014 and will continue to study other possible technical amendments to the definitions of “earned compensation” and “average compensation” to help ensure that compensation practices of its participating employers do not pose negative actuarial impacts on PERS.

6. *While PEER finds no improper actions on the part of the current PERS Board, to improve the public’s confidence regarding the objectivity of the board in making decisions that affect the system, the Legislature should amend MISS. CODE ANN. Section 25-11-15 (1972) to revise the board’s composition as follows:*
 - *change one of the two system member positions provided for in subsection (c) (i.e., state employee members) and one of the two positions of a member receiving a retirement allowance as provided for in subsection (f) (i.e., retiree members); and,*
 - *replace these two members with individuals who are not members or retirees of the system, one appointed by the Governor and one appointed by the Lieutenant Governor. In making such appointments, the Governor and Lieutenant Governor should give preference to individuals with expertise in investments or financial management.*

Also, the Legislature should amend subsection (b) of MISS. CODE ANN. Section 25-11-15 (1972) to state that in making this appointment (i.e., the gubernatorial appointment currently required by law), the Governor should give preference to an individual with expertise in investments or financial management.

PERS Response to Recommendation 6:

PERS does not believe that changes to the composition of the Board of Trustees are needed. Regardless of the constituency group or state official that elected or appointed him or her, each board member has the fiduciary responsibility to manage the trust in the best interest of all the System’s members and beneficiaries.

As PEER concluded in this report “PERS is well organized for oversight of its investment portfolios, has access to needed investment expertise, and is supplied with the technical data needed to minimize or eliminate the risks that face a defined benefit public pension system.” Therefore, it seems

inconsistent to suggest a need for one or more individuals who are not members of the System and who have expertise in investments or financial management to be appointed to the Board. The Board employs a seasoned chief investment officer, who is a chartered financial analyst, and an investment-consulting firm staffed with a team of experts in investments and financial management who help the Board guide the investment program. Moreover, the Board employs 34 investment management firms to manage the 44 different investment portfolios. Additional appointed board members, no matter their backgrounds, could not match the current years and wealth of expertise already accessed by the Board under its current investment program structure.

Further, PERS does not agree that adding individuals to the Board who are not members of the System and who have investment or financial expertise would “*improve the public’s confidence regarding the objectivity of the board in making decisions that affect the system.*” PERS contends that the 175 members of the Legislature are elected by and represent the interests of all taxpayers, including the 163,000 public employees working and paying taxes today. Moreover, the Legislature, not the Board, establishes public policy, including benefits offered to public employees. Since the Legislature establishes the benefit structure, and the PERS Board administers the benefits as prescribed by law, a structure of checks and balances already exists that should help to ensure public confidence in the objectivity of the decisions made that affect the System.

7. *As addressed by PEER in at least two previous reports (see PEER reports #191 and #273 at www.peer.state.ms.us), PERS should seek an appropriation for all of its administrative expenditures, including investment managers’ fees, trading costs, and other investment-related fees. Since PERS is a state agency and not a private corporation, it is subject to the budgetary laws of the state as well as to the Legislature’s constitutional authority to make appropriations.*

PERS Response to Recommendation 7:

In an Attorney General Opinion dated February 19, 1988, PERS was advised that the payment of investment manager fees as an investment expense similar to the payment of transaction costs from non-appropriated, non-budgeted funds is within the authority of the PERS Board of Trustees. In addition, legislation passed in 1989 further clarified authorization for payment of PERS’ manager fees as an investment expense rather than as a budgeted, appropriated administrative expense.

Investment expenses, including trading costs and manager fees, are fully reflected in both the Financial and Investments sections of PERS’ audited Comprehensive Annual Financial Report. This report is available to the Governor, Legislature, all members of PERS, and the general public at any time on the PERS website at www.pers.state.ms.us.

Please contact me at 601-359-2241 if you need further information. Thank you.

Sincerely,



Pat Robertson
Executive Director

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