

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

Report to
the Mississippi Legislature



An Update on the Financial Soundness of the Mississippi Public Employees' Retirement System and Related Legal Issues

Over the past year, the Public Employees' Retirement System (PERS) Board, with assistance from its staff and other contractual advisors, has adopted changes in the actuarial assumption methods for FY 2013, including salary increases, mortality rates, withdrawal rates, disability rates, and retirement rates. The cumulative effect of these assumption changes was a decrease in the unfunded actuarial accrued liability of \$226.1 million.

The PERS Board also adopted a revised funding policy in October 2012. This revised funding policy is designed to address the volatility of employer contribution rates within the PERS system by changing the employer contribution rate percentage to a fixed rate of 15.75% of annual compensation. The policy also targets an 80% funding level by 2042, while still reducing the plan's unfunded actuarial accrued liability. In addition to these effects, the funding policy change will have the effect of creating more long-term sustainability within the PERS system.

PERS's current strategy for risk management, if successful, will improve the unfunded liability over the next year and should yield a projected funding ratio of 94.3% as of 2043. While a 2013 amendment to MISS. CODE ANN. §25-11-121 (1972) could allow for participation in riskier investment vehicles, PERS should be able to mitigate this risk through application of its newly adopted asset allocation model and established risk management policies.

Regarding recent legal actions involving states' attempts to modify benefits of their retirement systems, several states' legislative bodies have enacted laws changing their retirement systems' contribution rates, the number of years to retirement, and the value of service credit. In some instances, employees or unions have objected to the changes and sought judicial relief by asserting that the changes violated state and federal constitutional provisions. In the cases litigated, the contractual rights of employees and retirees have been upheld. Some jurisdictions take a more restrictive view of contractual rights than do others. Several litigants have challenged the calculation of cost-of-living adjustments (COLAs). Ongoing Colorado and Washington litigation dealing with COLAs could be of significance to debate in Mississippi.

January 6, 2014

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.

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

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

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

PEER Committee
Post Office Box 1204
Jackson, MS 39215-1204

(Tel.) 601-359-1226
(Fax) 601-359-1420
(Website) <http://www.peer.state.ms.us>

The Mississippi Legislature

Joint Committee on Performance Evaluation and Expenditure Review

PEER Committee

SENATORS
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KELVIN E. BUTLER
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STEVE HORNE
MARGARET ELLIS ROGERS
PERCY W. WATSON

TELEPHONE:
(601) 359-1226

FAX:
(601) 359-1420

Post Office Box 1204
Jackson, Mississippi 39215-1204

Max K. Arinder, Ph. D.
Executive Director

www.peer.state.ms.us

OFFICES:
Woolfolk Building, Suite 301-A
501 North West Street
Jackson, Mississippi 39201

January 6, 2014

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

On January 6, 2014, the PEER Committee authorized release of the report entitled **An Update on the Financial Soundness of the Mississippi Public Employees' Retirement System and Related Legal Issues.**

A handwritten signature in cursive script that reads "Ray Rogers".

Representative Ray Rogers, Chair

This report does not recommend increased funding or additional staff.

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An Update on the Financial Soundness of the Mississippi Public Employees' Retirement System and Related Legal Issues

Executive Summary

Introduction

In December 2012, the PEER Committee issued Report #564, entitled *The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness*. This report includes an update on changes in the system's actuarial assumptions, as well as its risk management and investment management practices, that took place between December 2012 and December 2013.

Because of the ever-changing legal landscape affecting public pensions, this report also provides an update on results of litigation from other states since December 2012 that address employees' contractual rights in public retirement systems.

Update on Financial Soundness of PERS

Actuarial Soundness and Sustainability

Actuarial soundness and sustainability are two of the major contributing factors the PEER Committee established as components of financial soundness in its 2012 report on PERS. The focus of these two concepts should be to create a system and actuarial assumption models that are able to be upheld and defended in light of all relevant environmental conditions, including contractual obligations involved and the potential economic consequences of abrogating those obligations.

Update: PERS's Actuarial Soundness

Over the past year, the PERS Board, with assistance from its staff and other contractual advisors, has endeavored to maintain the actuarial soundness of the plan. The PERS Board reviewed the results of an experience valuation conducted by the independent actuarial consulting firm Cavanaugh Macdonald Consulting, LLC, for the four-year period ended June 30, 2012. Subsequently, the board adopted changes in the actuarial assumption methods for

FY 2013, including salary increases, mortality rates, withdrawal rates, disability rates, and retirement rates. The cumulative effect of these assumption changes was a decrease in the unfunded actuarial accrued liability of \$226.1 million.

Update: PERS's Sustainability

The PERS Board of Trustees adopted a revised funding policy in October 2012. This revised funding policy is designed to address the volatility of employer contribution rates within the PERS system by changing the employer contribution rate percentage to a fixed rate of 15.75% of annual compensation. The policy also targets an 80% funding level by 2042, while still reducing the plan's unfunded actuarial accrued liability. In addition to these effects, the funding policy change will have the effect of creating more long-term sustainability within the PERS system.

Risk Management and Investment Management

Risk management and investment management should provide a long-term framework for the system that will manage the plan's long-term risk environment in ways that allow it a reasonable opportunity to collect or earn sufficient assets to meet its benefit obligations.

Update: PERS's Risk Management

PERS's current strategy for risk management, if successful, will improve the unfunded liability over the next year and should yield a projected funding ratio of 94.3% as of 2043.

Update: PERS's Investment Management

While a 2013 amendment to MISS. CODE ANN. §25-11-121 (1972) could allow for participation in riskier investment vehicles, PERS should be able to mitigate this risk through application of its newly adopted asset allocation model and established risk management policies.

Recent Legal Actions Involving States' Attempts to Modify Retirement Benefits for Current Pension Members and Retirees

Legal Risks Associated with Making Changes in PERS

In its 2012 report, the PEER Committee provided information regarding possible legal risks associated with making changes in the current retirement system for

retirees and current PERS members. Briefly, the report set out the following principles pertinent to the Mississippi retirement system as administered by PERS:

- There exists a contractual relationship between the employee members of PERS and the state. This relationship also exists between retirees and the state. An employee's contractual rights accrue at the time of employment.
- Changes in benefits for retirees and current employees, whether past or future, may violate the contracts clauses of the Mississippi and United States constitutions.
- Such impairments, if substantial, are not tolerated under law unless they are reasonable and unless they are also followed with compensating benefits to the employee or retiree. This is known as the California Rule.

PEER's 2012 report provided an in-depth analysis of how courts have applied these principles and further discussed instances wherein courts have chosen to apply different principles in cases involving modifications to state pension systems. This update report provides an overview of significant cases that have been rendered or filed since the 2012 PEER report on PERS.

Update: States' Modifications of Members' Contribution Rates, Minimum Years to Retirement, or Value of Service Credit

Several states' legislative bodies have enacted laws changing their retirement systems' contribution rates, the number of years to retirement, and the value of service credit. In some instances, employees or unions have objected to the changes and sought judicial relief by asserting that the changes violated state and federal constitutional provisions. In the cases litigated, the contractual rights of employees and retirees have been upheld. Some jurisdictions take a more restrictive view of contractual rights than do others.

Update: States' Modifications of Cost-of-Living Adjustments

Several litigants have challenged the calculation of cost-of-living adjustments (COLAs). Ongoing Colorado and Washington litigation dealing with COLAs could be of significance to debate in Mississippi.

Analysis of Recent Legal Actions

While the litigation so far resolved is of little interest to Mississippi, ongoing litigation in Oregon and California

could have an impact, as these states have historically offered considerable protection to both past and future benefits.

Conclusion

PERS has a prudent and disciplined process that relies on expert actuarial guidance built upon reasonable assumptions and targets for portfolio growth. Continued competent, prudent management gives PEER every indication that PERS is moving toward reducing both the amortization period for the system and reducing the unfunded accrued liability.

For More Information or Clarification, Contact:

PEER Committee
P.O. Box 1204
Jackson, MS 39215-1204
(601) 359-1226
<http://www.peer.state.ms.us>

Representative Ray Rogers, Chair
Pearl, MS

Senator Nancy Collins, Vice Chair
Tupelo, MS

Senator Kelvin Butler, Secretary
McComb, MS

An Update on the Financial Soundness of the Mississippi Public Employees' Retirement System and Related Legal Issues

Introduction

Authority

MISS. CODE ANN. Section 25-11-101 (1972) directs the PEER Committee to:

. . . have performed random actuarial evaluations, as necessary, of the funds and expenses of the Public Employees' Retirement System and to make annual reports to the Legislature on the financial soundness of the system.

The PEER Committee, utilizing its authority found in MISS. CODE ANN. Section 5-3-51 et seq. (1972), carried out the statutorily required review of the financial condition of the Public Employees' Retirement System (PERS). Actuarial reviews authorized by this section are discretionary.

Scope and Purpose

PEER's 2012 report *The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness* (Report #564, December 11, 2012) set out the attributes of a financially sound retirement system. This report includes an update on changes in the system's actuarial assumptions, as well as its risk management and investment management practices, that took place between December 2012 and December 2013.

Because of the ever-changing legal landscape affecting public pensions, this report also provides an update on results of litigation from other states since December 2012 that address employees' contractual rights in public retirement systems.

Method

In conducting this review, PEER:

- reviewed financial reports of the Public Employees' Retirement System;
- reviewed actuarial reports, projections, and experience investigations prepared for PERS;
- reviewed generally accepted accounting principles pertinent to accounting for public pension systems;
- interviewed personnel of the Public Employees' Retirement System; and,
- reviewed significant case law from other jurisdictions rendered in 2013 that addresses employees' contractual rights in employment benefits.

Background

In recent years, retirement plans have become a major tool for recruiting employees to state government. In the past, many thought of retirement plans as a mere gratuity, but today they provide a method by which public sector employers can compete for staff in a competitive job market. While many positions in private sector employment may offer higher salaries, public sector employers can offer a pension program that offers their employees a means to a comfortable retirement. Some private sector employers no longer offer such.

Most Mississippi public employees receive their retirement benefits from the Mississippi Public Employees Retirement System. This system, dating from 1952, serves employees in state and local government, as well as educators in the K-12 and college levels of employment. MISS. CODE ANN. Section 25-11-101 (1972) provides, in part:

A retirement system is hereby established and placed under the management of the board of trustees for the purpose of providing retirement allowances and other benefits under the provisions of this article for officers and employees in the state service and their beneficiaries. . . .

Following the serious recession of the latter part of the first decade of the 2000s, many persons became concerned about the financial soundness of PERS and raised questions regarding the possibility of major restructuring of eligibility rules and benefits for current and future system members. To address these concerns and questions, the PEER Committee produced Report #564 (*The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness*) in 2012. That report provides:

- background information on PERS and the programs it administers;
- detailed information on the composition of the PERS Board of Trustees; and,
- the legal basis for the state's provision of retirement benefits to public employees

Report #564 also sets out an analysis of PERS's financial soundness and its investment and risk management practices. (See Appendix A, page 21, for the executive summary of Report #564. The executive summary and full report are also available at www.peer.state.ms.us.)

This 2013 report provides a concise overview of where the system currently stands financially and provides an update on recent legal actions involving states' attempts to modify retirement benefits for pension systems' members and retirees.

Update on Financial Soundness of PERS

PEER established in Report #564 that the term “financial soundness” should be defined not as a point-in-time comparison of assets and liabilities, but 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 and investment management in the long-term financial health of the system.

The PERS Board has adopted and implemented policies and procedures that allow it to address the major contributing areas to the plan’s financial well-being and to carry out its fiduciary responsibilities to its active members and retirees. These policies and procedures fall into the following contributing areas:

- actuarial soundness and sustainability; and,
- risk and investment management.

This chapter will discuss each contributing area and highlight relevant activity and changes to PERS for the last fiscal year and future projections.

Actuarial Soundness and Sustainability

Actuarial soundness and sustainability are two of the major contributing factors the PEER Committee established as components of financial soundness in its 2012 report on PERS. The focus of these two concepts should be to create a system and actuarial assumption models that are able to be upheld and defended in light of all relevant environmental conditions, including contractual obligations involved and the potential economic consequences of abrogating those obligations.

Actuarial Soundness

Over the past year, the PERS Board, with assistance from its staff and other contractual advisors, has endeavored to maintain the actuarial soundness of the plan. The PERS Board reviewed the results of an experience valuation conducted by the independent actuarial consulting firm Cavanaugh Macdonald Consulting, LLC, for the four-year period ended June 30, 2012. Subsequently, the board adopted changes in the actuarial assumption methods for FY 2013, including salary increases, mortality rates, withdrawal rates, disability rates, and retirement rates. The cumulative effect of these assumption changes was a decrease in the unfunded actuarial accrued liability of \$226.1 million.

Over the past year, the PERS Board, with assistance from its staff and other contractual advisors, has endeavored to maintain the actuarial soundness of the plan by making changes to actuarial assumptions. Changes to actuarial assumptions allow more accurate and realistic projections of future performance and help to minimize the misallocation of resources by more fairly distributing costs among the generations of taxpayers.

The board reviewed the results of an experience valuation conducted by the independent actuarial consulting firm Cavanaugh Macdonald Consulting, LLC, for the four-year period ended June 30, 2012. Subsequently, the PERS Board of Trustees adopted changes in the actuarial assumption methods for FY 2013 to several areas, including salary increases, mortality rates, withdrawal rates, disability rates, and retirement rates. The cumulative effect of these assumption changes was a decrease in the unfunded actuarial accrued liability of \$226.1 million.

As noted above, the accuracy of the assumptions used have an impact on the future projections of the plan. At present, the actuarial model is predicting an annual increase of 4.25% for total annual payroll made up of component factors for price inflation and real wage growth. In reality, total payroll decreased 0.58% from FY 2012 to FY 2013, with an average annual payroll increase of 2.65% over the last ten years. These figures are important because not meeting the projection goals puts added pressure, over the long term, on other areas of the plan to support the payment of future benefits.

While PERS did adopt changes to the actuarial assumptions on wage inflation for FY 2013, this is one area where future continual assessment is necessary.

Sustainability

The PERS Board of Trustees adopted a revised funding policy in October 2012. This revised funding policy is designed to address the volatility of employer contribution rates within the PERS system by changing the employer contribution rate percentage to a fixed rate of 15.75% of annual compensation. The policy also targets an 80% funding level by 2042, while still reducing the plan's unfunded actuarial accrued liability. In addition to these effects, the funding policy change will have the effect of creating more long-term sustainability within the PERS system.

To help address the volatility of the employer contribution rate, the PERS Board of Trustees, at its October 2012 meeting, adopted a revised funding policy for Fiscal Year 2014 and subsequent future years. The revised funding policy changes the employer contribution rate percentage from an annually calculated actuarial valuation to a fixed rate of 15.75% of annual compensation. The revised funding policy also targets an 80% funding level by 2042 while still reducing the plan's unfunded actuarial accrued

liability. In addition to the effects listed above, PEER notes that this funding policy change should have the effect of creating more long-term sustainability within the PERS system.

While this policy change has created stability within the employer contribution rate, for 2013 it reduced the funding available for allocation to the unfunded accrued liability. This policy change, in conjunction with the low salary growth and continued recognition of actuarial smoothed losses from 2009 and 2012, has contributed to the increase of the anticipated accrued liability payment period from 30 years to 32.2 years, on an actuarial basis. While an increase in the anticipated accrued liability payment period continues the negative trend of the last few years, it is important to note that this increase was expected, as outlined in projection reports adopted by the PERS Board of Trustees during its December 2012 meeting.

This increase in the anticipated accrued liability payment period does extend the anticipated payment period past the thirty-year limitation set by Governmental Accounting Standards Board (GASB) Statements 25 and 27. While the PERS plan no longer complies with the provisions laid out in GASB Statements 25 and 27, it must be noted these provisions are not requirements, but are recognized as industry practice standards.

As an obligation of the state, failure of the PERS system to comply with industry standards could be used as one of many factors in bond rating agencies' assessment of Mississippi's potential bond rating outlook. While PERS's non-compliance with GASB Statements 25 and 27 could be seen as a potential negative, the severity of such breaches is not as dire as one would imagine. Since the completion of Fiscal Year 2013, KMPG LLP has completed its annual auditors' report on the PERS system and has issued this report with an unqualified opinion.

Further, the GASB recommendations contained within GASB Statement 25 will be superseded by new GASB Statement 67 effective for the PERS plan's Fiscal Year 2014. This new statement eliminates the use of a thirty-year amortization period for calculation of a pension plan's annual required contribution for financial reporting purposes. The new statement does not address funding requirements for pension plans. Funding decisions remain a matter of government policy.

As noted previously, the increase in PERS's anticipated accrued liability payment period was also the result of continued recognition of past years' actuarially smoothed losses from 2009 and 2012. Actuarially smoothed gains and losses are recognized over a five-year period. For FY 2013, the PERS system recognized gains and losses from FY 2009 through FY 2013 for a combined investment loss of approximately \$400 million. This combined loss

included the recognition of the last year of losses from 2009, which were losses of approximately \$1.05 billion per year. The PERS system will benefit from actuarial smoothing with prior fiscal year activity having a positive effect on three of the next four fiscal years.

Risk Management and Investment Management

Risk management and investment management should provide a long-term framework for the system that will manage the plan's long-term risk environment in ways that allow it a reasonable opportunity to collect or earn sufficient assets to meet its benefit obligations.

Risk management and investment management are the other two areas PEER has identified as major contributing factors of components of financial soundness. Risk management and investment management seek to provide a long-term framework for the system that will manage the plan's long-term risk environment in ways that allow it a reasonable opportunity to collect or earn sufficient assets to meet its benefit obligations.

Risk Management

PERS's current strategy for risk management, if successful, will improve the unfunded liability over the next year and should yield a projected funding ratio of 94.3% as of 2043.

For FY 2013, the actuarial value of PERS's assets fell in relation to the actuarial value of its liabilities--from 58% to 57.7%. As with the anticipated accrued liability payment period noted previously, the relationship between these two valuations weakened due to the continued effects of the 2009 losses and as a result of a fixed employer contribution rate. As with the anticipated accrued liability payment period discussed previously, PEER notes that this dip is in line with projections adopted by the PERS Board of Trustees during its October 2012 meeting.

For the purposes of calculating PERS's accrued liabilities, the lower than projected salary increases reduced PERS's accrued liabilities approximately \$350 million for Fiscal Year 2013. However, this benefit also affects the calculation of the plan's accrued liabilities in the short term. Any short-term benefits might not be able to outweigh the long-term effects of lower than predicted salary growth previously noted.

Projections provided by Cavanaugh Macdonald and adopted by the PERS Board of Trustees during its December 2013 meeting show the funding ratio moving to 60.02% for Fiscal Year 2014 and to 91.02% as of 2042. These projections show an increase from the originally

adopted model's projection of a funding level of 85.1% at 2042.

The projection reports also include snapshots of the plan's funding levels at various increments over the next thirty years, culminating with a projected funding level of 94.3% at 2043. For more information on these incremental projections, please see Appendix B, page 29.

As with all projections, care must be taken in the adoption of the information provided. For the projected information to be accurate, all actuarial assumptions used in the projection must be met exactly for all thirty fiscal years forecasted. As past performance shows, this mark can be missed on both the high and low sides, creating variability from the model.

For Fiscal Year 2013, PERS's total investments, before securities lending activities, approximated \$21.9 billion, an increase of \$2.3 billion from Fiscal Year 2012. The combined investment portfolio experienced a return of 13.4% compared with a median large public plan return of 12.7%.¹ During the last ten years, PERS's investment return on assets averaged 7.17%, as opposed to the targeted return of 8%. Investment returns ranged from a -19.4% during FY 2009 to 25.4% during FY 2011. Historically, PERS's investment returns have averaged 7.47% during the last twenty years and 9.10% over the last thirty years. The volatility of the recent years' returns reinforces the principle of viewing investment returns over a long period and comparing long-term returns to investment return goals.

Investment Management

While a 2013 amendment to MISS. CODE ANN. §25-11-121 (1972) could allow for participation in riskier investment vehicles, PERS should be able to mitigate this risk through application of its newly adopted asset allocation model and established risk management policies.

Pertinent to investment management of the PERS system, two changes were made in 2013: a statutory amendment regarding PERS's investments and the PERS Board's adoption of a new asset allocation model.

¹"Large public plans" are plans with greater than \$10 billion in investment assets.

2013 Statutory Amendment

The 2013 amendment provides PERS investment managers with additional investment opportunities and modernizes certain management practices. While the amendment gives new opportunities for investment, these changes are subject to PERS's existing investment management policies.

The first change was an amendment of MISS. CODE ANN. §25-11-121 (1972). This amendment was effected through Section 1, Chapter 428, *Laws of 2013*. The overall goals of this amendment were clarification of the existing law to be more consistent with how the portfolio is managed today, to describe more accurately the manner in which certain functions are handled, to expand the range of investment options available to PERS's investment managers, and to make sure PERS's current investment strategy conforms to statute. As an example, some of the more critical changes allow PERS investment managers to invest in agency and non-agency residential and commercial mortgage-backed securities and collateralized mortgage obligations, asset-backed securities, or to invest in currency through foreign or domestic banks.

While it has been noted that some of these changes could potentially open PERS's plans up to increased levels of investment risk, these changes must also be taken in context with other areas of PERS's investment management. PERS has developed investment risk mitigation policies that cover many areas of the investment landscape. Some of these include, but are not limited to, qualification standards for all investment managers and consultants, asset allocation modeling done by individual asset class, investment measurement service quarterly reviews, and periodic asset/liability studies. These tools are used by PERS staff and the PERS Board of Trustees to assess performance measures and risk versus return results. (For more information on PERS's risk management policies, please see pages 59-81 of PEER Report #564.)

Adopted of a New Asset Allocation Model

The PERS Board of Trustees adopted a new asset allocation model effective July 2013.

The second change made during Fiscal Year 2013 was the PERS Board of Trustees' adoption of a new asset allocation model effective July 2013. The asset allocation model dictates the types of asset classes the PERS system will invest in and the overall weight of each investment area relative to the plan as a whole.

The PERS Board of Trustees and PERS staff use this model to mitigate investment risk by creating target performance

levels for each asset class, and reviewing, on a quarterly basis, the performance of each investment manager relative to their asset class's target performance level.

The exhibit below shows the 2013 changes in PERS's asset allocation model.

Exhibit: PERS's Most Recent Asset Allocation Model Changes

Year	Fixed Income	Public Equity	U.S. Equity	Non-U.S. Equity	Real Estate	Absolute Return	Private Equity	Cash
2010	27%	53%			10%	5%	5%	0%
2013	20%		34%	27%	10%	0%	8%	1%

SOURCE: Information provided by PERS staff.

By adopting the new asset allocation policy, PERS has reduced its percentage of investment in the fixed income and absolute return asset classes, created a defined cash reserve, and increased its investment in the equity asset classes. As a side note, PERS's investment allocation has always had defined levels of U. S. and non-U.S. equity investment, in practice, but the new model creates a clearer picture of the weights of these individual asset classes.

Recent Legal Actions Involving States' Attempts to Modify Retirement Benefits for Current Pension Members and Retirees

In its 2012 report, the PEER Committee provided information regarding possible legal risks associated with making changes in the current retirement system for retirees and current PERS members. Briefly, the report set out the following principles pertinent to the Mississippi retirement system as administered by PERS:

- There exists a contractual relationship between the employee members of PERS and the state. This relationship also exists between retirees and the state. An employee's contractual rights accrue at the time of employment.
- Changes in benefits for retirees and current employees, whether past or future, may violate the contracts clauses of the Mississippi and United States constitutions.
- Such impairments, if substantial, are not tolerated under law unless they are reasonable and unless they are also followed with compensating benefits to the employee or retiree. This is known as the California Rule.

PEER's 2012 report provided an in-depth analysis of how courts have applied these principles and further discussed instances wherein courts have chosen to apply different principles in cases involving modifications to state pension systems.

While the 2012 report notes that modifications to the PERS program for current members and retirees is fraught with legal risks, several states have taken the step toward modifying their programs for current employees and retirees, thereby accepting the risk of litigation. The following discusses recent actions and instances wherein states have litigated specific types of pension modifications for current members or retirees. These cases most often hinge on court interpretations of state constitutional provisions protecting contractual rights. Generally, these state pension modification efforts have focused on two areas of pension benefits:

- changing members' contribution rates, minimum years to retirement, or value of service credit; and,
- the calculation and availability of cost-of-living adjustments for retirees.

This chapter provides an overview of significant cases that have been rendered or filed since the 2012 PEER report on PERS.

States' Modifications of Members' Contribution Rates, Minimum Years to Retirement, or Value of Service Credit

Several states' legislative bodies have enacted laws changing their retirement systems' contribution rates, the number of years to retirement, and the value of service credit. In some instances, employees or unions have objected to the changes and sought judicial relief by asserting that the changes violated state and federal constitutional provisions. In the cases litigated, the contractual rights of employees and retirees have been upheld. Some jurisdictions take a more restrictive view of contractual rights than do others.

Several states have in recent years adopted changes in these areas (i. e., members' contribution rates, minimum years to retirement, or value of service credit) in an attempt to bolster the financial soundness of their pension plans. In several instances, employees or unions objected to the changes and sought judicial relief by asserting that the changes violated state and federal constitutional provisions protecting against the abrogation of contract rights. It appears that in the cases litigated, many changes have not been upheld and the contractual rights of employees and retirees have been upheld.

In this section, PEER has reported styles of cases only in instances wherein an appellate court has rendered a final decision or there is a trial decision that is final.

Arizona

Arizona enacted retirement contribution increases for active employees in 2011. Several challenges were lodged against these changes. Following a Maricopa County Superior Court ruling that increased contribution rates for active members of the state's retirement system violated the contracts clauses of the Arizona and United States constitutions, the Arizona Legislature chose to repeal the legislation it had adopted raising contribution rates. See *Barnes v. Arizona Retirement System* (CV: 2011-011638).

Florida

In a case rendered by the Florida Supreme Court in 2013, the court ruled that prospective changes in the Florida Retirement System were constitutional, as they required members to pay a 3% salary contribution to the plan. Apparently, since 1974, most positions in the Florida Retirement System had been non-contributory. Changes in

non-contributory plans had always been held to be permissible in Florida for prospective changes. In this case, the Florida Supreme Court made clear that a requirement for making a contribution was a prospective change that did not impair vested rights and that employees had no protected right to future benefits under a particular set of legal provisions. See *Scott v. Williams*, 107 So. 3d 379 (Fla. 2013).

Florida takes the position that the contracts clause does not bar future legislatures from prospectively altering benefits that accrue for future state service. Mississippi, through its application of the California Rule, appears to protect future benefits as well as those already accrued.

New Hampshire

New Hampshire enacted several changes to the state's pension system. These changes included:

- changes to earnable compensation for members with fewer than ten years of service;
- increasing the number of years used to compute average final compensation from three years to five;
- lowered limit on the maximum initial pension benefit for members with fewer than ten years of service;
- increased retirement age with a reduced multiplier;
- increased contribution rates for current and future members; and,
- changes to the definition of earnable compensation.

As of the summer of 2013, a trial court judge had held that the changes, as they affect vested employees, violate the contracts clause of the United States Constitution. The cases are being appealed to the New Hampshire Supreme Court. See *AFT v. State*, (Merrimack County Superior Court, 2012), *Professional Firefighters of New Hampshire v. State* (Merrimack County, 2012), and *Professional Firefighters of New Hampshire et al. v. State* (Hillsborough County, 2012).

Ohio (Cincinnati Municipal Retirement System)

The City of Cincinnati made several changes in its municipal pension system. These included an increase in active employee contributions, changes in the age at which an employee is eligible for retirement, and changes in creditable service calculations. An active employee member brought suit against the city in the United States District Court for the Southern District of Ohio in which the employee alleges impermissible impairment of contract. Trial was set for the end of October 2013. PEER

has found no evidence of a ruling in the case as yet. See *Sunyak v. City of Cincinnati*, United States District Court, Southern District Ohio, 2013.

Rhode Island

Rhode Island made major changes in its pension program for current members and retirees. Late in 2012, a Rhode Island court found that there exists an implied contract between members of a retirement system and the state that cannot be substantially impaired when the active member has become vested. The result of this decision was to imperil major pension changes in the state that affected retirement age, calculation of years of service, and final average salary. Employees were also moved to hybrid plans. Following the court's decision in 2012, the trial judge submitted the matter to a mediator. As of this date, no report has been produced showing a possible resolution of these claims. See *Rhode Island Public Employees Retiree Coalition v. Chaffee*, Rhode Island Superior Court, 2012.

Texas (Fort Worth Municipal Retirement System)

In August 2013, a state court judge ruled that certain changes to a Fort Worth municipal retirement system were constitutional, as they affected only future accruals of benefits. The changes included modifying the multiplier for future years of service, raising the number of years used to calculate salary for retirement purposes, and removing overtime from the calculation of compensation.

At this time, a federal judge in Fort Worth has lifted a stay of proceedings in a similar federal case challenging these changes.

Other Jurisdictions

Perhaps more important than the cases cited is litigation ongoing in California and Oregon dealing with pension reform efforts in those states. Several of these reforms have affected current employees and include increases in employee contributions and changes in retirement age.

At present there are no decisions to report, yet these decisions will contribute considerably to the case law on pension reform because the two states have traditionally applied the California Rule to protect not only accrued benefits but future accruals as well. These jurisdictions have traditionally found a contractual right of current members in future, as well as past, accrued benefits, except in cases wherein some compensating benefit is

offered in return for an impairment of the terms or benefits currently offered.

States' Modifications of Cost-of-Living Adjustments

Several litigants have challenged the calculation of COLAs. Ongoing Colorado and Washington litigation dealing with COLAs could be of significance to debate in Mississippi.

Cost-of-living adjustments, usually called COLAs, have been the subject of considerable recent litigation. COLAs are often provided in accordance with a strict formula set in law. In some cases, the COLA is calculated on an ad hoc basis driven by the pension plan's investment performance. Many pension reformers have seen COLA reduction or elimination as a potential avenue for reducing pension system costs, thereby bolstering the financial soundness of such systems. Retirees and active employees often take the position that the COLA is a contractual right that may not be impaired. The following discusses recent case law on COLA modification or elimination.

Colorado

In the 2012 report, PEER reported that Colorado had adopted a legislative modification of its COLA for state employees. Following the change, retirees challenged the constitutionality of the change, arguing that they were contractually entitled to have their COLAs calculated using the formula in effect at the time of their retirement, rather than the fixed COLA that was offered as a substitute.

At trial, the court rendered summary judgment for the state without conducting contracts clause analysis. This decision was reversed and remanded by an appeals court that directed the lower court to conduct the necessary analysis to determine whether there has been a substantial impairment of a contract and if there is a reasonable basis for such. Not satisfied with the result, the plaintiffs filed for a writ of certiorari with the Colorado Supreme Court under which they may argue that their contractual rights have been impaired by the COLA change. See *Justus v. State of Colorado* (writ granted August 5, 2013).

Maine

In 2011, the Maine Legislature reduced cost-of-living adjustments granted to state retirees. Plaintiff retirees brought suit against the state alleging contracts clause violations in that the reductions impair their contracts with the state. The case was filed in the United States District Court for Maine. On June 23, 2013, the court

dismissed the case, citing failure on the part of the plaintiffs to show that there was in fact a contract between themselves and the state of Maine. See *Maine Association of Retirees, v. Board of Trustees* (United States District Court for Maine, 2013).

Washington

COLA litigation began in Washington in 2011. In that year, Washington eliminated the COLA for retirees in two of the state's older retirement systems. Neither system has taken in new members since 1977. At issue is whether the Legislature can repeal the COLA when the legislation authorizing it contained a clause reserving the Legislature's right to abolish or modify the COLAs. At the trial level, the plaintiff retirees prevailed, successfully arguing that the elimination constituted an abrogation of contractual rights. The Washington Supreme Court heard oral arguments in the case on October 25, 2013. See *Washington Federation of State Employees v. State of Washington* (Thurston County Superior Court, 2012).

Louisiana

In December of 2013, the Louisiana Court of Appeals for the Fourth Circuit ruled in *New Orleans Fire Fighters Pension & Relief Fund v. City of New Orleans*, 2013-CA-0873, that it was proper for a trial court to direct the city to fund certain pensions in accordance with a statutory requirement even though such would have a deleterious impact on the city's budget.

New Mexico

Likewise, in late December 2013, the New Mexico Supreme Court ruled that retired pensioners who sought judicial relief ordering the state to fund their COLAs using the same formula used at the time of retirement had no contractual right to such funding. The court stressed that COLAs had historically varied from year to year and as such, no one had a reasonable expectation in a COLA being calculated in any particular manner.

Analysis of Recent Legal Actions

While the litigation so far resolved is of little interest to Mississippi, ongoing litigation in Oregon and California could have an impact, as these states have historically offered considerable protection to both past and future benefits.

Cases in California, New Hampshire, and Oregon will be of significance, as their courts will be addressing major attempts to change the pension systems upon which public employees rely. It would appear that the litigation in California and Oregon will be of the greatest significance, as these states have historically applied the California Rule that protects rights from the time employees join state service, including future benefits. Cases from these jurisdictions may be decided by the end of 2014.

Additionally, Colorado and Washington litigation dealing with COLAs will also be significant. In both cases, the supreme courts of these states will have to determine whether the COLA is a part of the contract between the employee and the state and if so, how much of a COLA can an employee reasonably count on as adequate compensation.

Conclusion

PERS has a prudent and disciplined process that relies on expert actuarial guidance built upon reasonable assumptions and targets for portfolio growth. Continued competent, prudent management gives PEER every indication that PERS is moving toward reducing both the amortization period for the system and reducing the unfunded accrued liability.

As noted in PEER's 2012 report, sound financial management is a long-term commitment to a disciplined, prudent process of managing for risk. While any particular year of returns may be high or low, sound financial management requires the Legislature to look more closely at how the system sets reasonable goals and manages for the inevitable movements that the market will experience over a long period.

This review shows that PERS has a prudent and disciplined process that relies on expert actuarial guidance built upon reasonable assumptions and targets for portfolio growth. Continued competent, prudent management gives PEER every indication that PERS is moving toward reducing both the amortization period for the system and reducing the unfunded accrued liability. Nothing in PEER's fieldwork indicates that the system is facing an imminent collapse that would be necessary to justify modifications to current members' benefits.

PEER notes that in other jurisdictions, legislatures facing conditions arguably far more dire than those in Mississippi have taken steps to modify the contributions, retirement age, or other benefits given to current system members and have made modifications to the COLAs of retirees. The legality of such changes is linked to the degree of protection these states confer upon the contractual rights of their system members and retirees. Generally, states such as Mississippi that employ the so-called California Rule will find it quite difficult to modify benefits, either past or future, of members. Litigation in California and Oregon and COLA litigation in Washington should be closely tracked, as it will show the extent to which any change in California Rule states could be considered acceptable.

Appendix A: Executive Summary of PEER Report #564, *The Public Employees' Retirement System of Mississippi: A Review of Selected Issues Related to Financial Soundness* (December 11, 2012)

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 contracts 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 contracts 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.

Appendix B: Thirty-Year Projection Results of the Mississippi Retirement Systems Plans, Prepared as of June 30, 2013

The information included in this appendix came from a report created by PERS's actuarial firm Cavanaugh Macdonald Consulting, LLC. This report, entitled *Report on Thirty Year Projections of the Mississippi Retirement Systems*, was prepared as of June 30, 2013. The PERS Board of Trustees adopted the projections in this report during its December 2013 meeting.

The information on page 30 shows projections for each of the three open defined benefits plans that are administered by the PERS staff. These plans include the Public Employees' Retirement System (PERS), the Mississippi Highway Safety Patrol Retirement System (HSPRS), and the Supplemental Legislative Retirement Plan (SLRP).

These projections are based on models created by PERS's actuarial firm that utilize a wide range of approved actuarial assumptions. These assumptions include, but are not limited to, funding policies, contribution requirements, returns on investment, pre-retirement withdrawals from service, retirements, deaths, disabilities, and the addition of new members. For all of the projections shown, an 8.00% assumed rate of return on investments has been used in the calculations.

As with all projections, the results of these projections must be taken with care. For the projected information in these tables to be realized and accurate, all funding policy decisions currently in place must remain unadjusted and all actuarial assumptions used in the projection must be met exactly for all thirty fiscal years forecasted. As past performance of PERS's funds has shown, these marks can be missed on both the high and low sides, creating variations between the model's projections and the real activities of the plans.

Public Employees' Retirement System Projection Results				
	2013	2018	2023	2043
Total Payroll	\$5,823,578	\$6,835,860	\$8,201,816	\$12,202,185
Unfunded Accrued Liability	\$15,052,293	\$15,769,141	\$17,432,669	\$17,352,970
Normal Cost Rate	2.07%	1.43%	0.99%	0.58%
Unfunded Accrued Liability Rate	13.68%	14.32%	14.76%	15.17%
Total Rate	15.75%	15.75%	15.75%	15.75%
Funding Ratio	57.7%	63.0%	64.7%	72.0%
Amortization Period	32 years	25 years	21 years	12 years

Mississippi Highway Safety Patrol Retirement System Projection Results				
	2013	2018	2023	2043
Total Payroll	\$25,816	\$30,341	\$36,748	\$55,262
Unfunded Accrued Liability	\$160,478	\$154,767	\$163,016	\$156,544
Normal Cost Rate	16.15%	15.93%	15.75%	15.61%
Unfunded Accrued Liability Rate	20.85%	21.07%	21.25%	21.39%
Total Rate	37.00%	37.00%	37.00%	37.00%
Funding Ratio	62.8%	69.0%	71.4%	78.6%
Amortization Period	33 years	23 years	19 years	11 years

Supplemental Legislative Retirement Plan Projection Results				
	2013	2018	2023	2043
Total Payroll	\$6,695	\$8,347	\$10,331	\$15,579
Unfunded Accrued Liability	\$6,424	\$6,338	\$7,147	\$6,087
Normal Cost Rate	2.82%	2.63%	2.54%	2.46%
Unfunded Accrued Liability Rate	4.58%	4.77%	4.86%	4.94%
Total Rate	7.40%	7.40%	7.40%	7.40%
Funding Ratio	67.8%	73.1%	73.4%	81.6%
Amortization Period	40 years	25 years	21 years	10 years

SOURCE: Report of Thirty Year Projections of the Mississippi Retirement Systems, Prepared as of June 30, 2013 by Cavanaugh Macdonald Consulting, LLC.

Agency Response



Providing Benefits for Life

January 9, 2014



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 *An Update on the Financial Soundness of the Mississippi Public Employees' Retirement System and Related Legal Issues*. As you acknowledge in the Report, the PERS Board of Trustees has adopted and implemented policies and procedures that should address the System's financial sustainability. Moreover, we agree that sound financial management is a long-term commitment to a disciplined, prudent process of managing for risk.

We acknowledge and appreciate the diligence and effort you and your staff expended in compiling this report, and we respect the professional manner in which the review was conducted. Please contact me at 601-359-2241 if you need further information. Thank you.

Sincerely,

Pat Robertson
Executive Director

PR:br

Pat Robertson
Executive Director

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