PEER MISSISSIPPI
Joint Legislative Committee on Performance Evaluation and Expenditure Review

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Report Highlights

December 16, 2019

2019 Update on Financial Soundness of the Public Employees' Retirement System

CONCLUSION: Financial soundness should be defined not as a point-in-time comparison of assets and liabilities, but as a multifaceted construct involving an understanding of the role of actuarial soundness in judging financial health, a broadly defined view of affordability that encompasses sustainability in consideration 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.

Background:

The Public Employees' Retirement System of Mississippi (PERS) is a defined benefits retirement plan for a majority of the employees (and/or their beneficiaries) of state agencies, counties, cities, colleges and universities, public school districts, and other participating political subdivisions. State law requires PEER to report annually to the Legislature on the financial soundness of PERS.

In addition to the PERS plan, Mississippi's public retirement system consists of five other retirement plans (or programs) that provide retirement allowances and other benefits to segments of Mississippi public employees.

The system is under the administration of the 10-member PERS Board of Trustees, which has a primary responsibility of ensuring adequate funding of the plans it administers. One means of accomplishing this task is by setting contribution rates for employers participating in the plans. For assistance in setting these rates, the PERS Board receives actuarial reports annually and works with independent actuarial advisers to develop comprehensive models that are used to project the financial position of the various plans. These models include such components as investment return assumptions, wage inflation assumptions, retirement tables, and retiree mortality tables.

Each of these components must work in concert with the others for the plan to maintain financial soundness. Underperformance in any one area can cause additional stress on other components of the plan and can lead to underperformance of the plan as a whole.

In addition to annual actuarial valuations and projection reports, the PERS Board biennially reviews the actual experience of the various plans to expected experience for reasonableness, and adjust, as necessary, the assumptions used.

Due to the timing of this year's report and a change in the release date of the PERS plan's annual valuation, this report provides a review of the PERS Board's actions (based on actuary recommendations concerning the plan's most recent experience study, and a limited review of the plan's financial stance).

This report also includes information on the use of "cost-of-living adjustments" by defined benefits plans across the country and an overview of the Mississippi Government Employees' Deferred Compensation Plan and Trust (MDC) and the results of a targeted survey of its members satisfaction.

PERS Economic Assumption Changes

The PERS Board, in consultation with its actuaries, develops an actuarial model based on such assumptions as projected investment returns, payroll increases, inflation, retirement ages, mortality rates, marriage rates, and accrued leave to project the system's future assets and liabilities. Although the PERS Board sets plan assumptions based on biennial experience studies, the plan's actual experience (e.g., investment returns or mortality rates) is a product of environmental and demographic factors.

Variances in the actual experience of the plan compared to the model's assumptions have an impact on the plan's financial condition. Therefore, the PERS Board, with assistance from its staff and other contractual advisers, endeavors to maintain the actuarial soundness of the plan by monitoring all components used in the PERS actuarial model through quarterly updates on the performance of the System's assets and annual actuarial updates in conjunction with annual projections and biennial experience reports.

Because of its most recent four-year experience study, ending June 30, 2018, the PERS Board adopted decreases in the plan's price inflation and wage inflation assumptions and adopted amendments to components of the plan's funding policy to install a method to reduce the plan's investment return assumption to the rate most recently recommended by the plan's actuary.

Assumption	FY 2019 and Future Years†	Most Recent Rate Prior to FY 2019
Price Inflation	2.75%	3.00%
Wage Inflation	3.00%	3.25%
Investment Return*	7.75%‡	7.75%

*Net of investment expense.
†The revised economic assumptions were also used in the valuation of system liabilities for FY2019.
‡The Board voted to adopt amendments to the plan's funding policy that will incrementally lower the investment return assumption rate to the rate recommended by the plan's actuary of 7.50% using the plan's future excess investment gains.

PERS Demographic Assumption and Other Assumption Changes

The demographic assumptions of the model seek to explain the effects of retirements (service and disability), withdrawals, mortality, and salary increases on the plan. These assumption levels are based on subsets of the plan members, grouped by age, gender, and years of service. These assumptions are assessed during the PERS Board's biennial experience studies to compare what happened to the membership of the plan during the evaluation period (the four-year period ending June 30, 2018) with what was expected to occur based on the assumptions used in the most recent actuarial valuations. Based on this study, the PERS Board adopted changes to many of its demographic assumptions, including adoption of the new Society of Actuaries' public retirement plan mortality tables.

Active Member to Retired Member Ratio

From FY 2009 through FY 2019, the ratio of active members to retired members decreased by approximately 36%, driven by an increasing number of retirees and a decreasing number of active members for the period. The ratio of active members to retired members fell to 1.37:1 during FY 2019 (down from 1.40:1 in FY 2018). However, for the first time since FY 2014, PERS number of active memberships remained flat.

As a maturing plan, PERS's model expects, and attempts to account for these increases, but this decrease results in the funding of future pension obligations over the payroll of fewer active members.

The PERS Board adopted a change in its assumption for the estimation of its administrative expenses (which is included in normal cost), of 0.02%, increasing the estimate from 0.23% to 0.25% of covered payroll.

Amendments to the PERS Funding Policy

During its October 2019 meeting, the PERS Board finalized the adoption of amendments to the plan's funding policy to reflect the method the PERS plan will use to lower its investment return assumption from its current rate of 7.75% to the actuary's recommended rate of 7.50%.

Unlike the one-time adoption of the plan's other assumption changes (price inflation assumption, wage inflation assumption, and demographic assumptions) the PERS Board's adoption of the change in the investment return assumption will be phased in over time utilizing any excess returns, above the current 7.75%, generated by the plan's investments in future periods.

Investment Management

FY 2019 investment manager fees of $104.1 million were less than the fees paid in FY 2018 ($104.8 million), and represented a combined investment manager expense rate of 0.36%.

For FY 2019, PERS plan's combined investment portfolio realized a return of approximately 6.87% while the market value of assets grew from approximately $28.1 billion to $28.6, an increase of approximately $0.5 billion.

PERS investment performance for FY 2019 was below the current actuarial model's target investment return of 7.75% and placed it above the median return for its peer group of 6.56%. Additionally, PERS investment performance has exceeded its peer group median for each of the past three-, five-, and 10-year periods (ranking in the top 15% over each of these periods).

Cost of Living Adjustment

Under MISS. CODE ANN. Section 25-11-112(1) (1972), PERS retirees receive a 3% cost-of-living adjustment that automatically increases annually, either by a simple or compounding method depending on the person's age and date of employment. According to information from the National Association of State Retirement Administrators December 2018 *NASRA Issue Brief: Cost-of-Living* Adjustments, like PERS, 36 of the 99 state-level public pension plans (in the survey) provide some form of compounded cost-of-living adjustment to retirees.

Mississippi Government Employees' Deferred Compensation Plan and Trust

The Legislature created the Government Employees' Deferred Compensation Plan and Trust (MDC) in 1973, later codified in MISS. CODE ANN. Section 25-14-1 et seq. (1972), as a supplementary, state-sponsored, voluntary deferred compensation plan for employees of various state and local government entities.

State Law charges the Public Employees' Retirement System (PERS) of Mississippi with the oversight and administration of MDC, which the PERS Board accomplishes through its Defined Contribution Committee. Under its authority as the administrator of the MDC, the PERS Board selects the investment options available within the plan.

Since the inception of the MDC, the PERS Board has administered the plan through a third-party administrator, currently Great-West Life & Annuity Insurance Company, who is doing business as Empower Retirement. As MDC's recordkeeper, Empower Retirement receives oversight through an annual attestation engagement audit, periodic compliance reviews from the Mississippi Secretary of State's Securities Division, and contractual metrics.