2018 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 valuation and projection reports, the PERS Board biennially reviews the actual experiences of the various plans to expected experience for reasonableness, and adjusts, as necessary, the assumptions used.

This report provides a concise overview of where the PERS plan currently stands financially and reviews the new funding policy implemented by the PERS Board in June 2018.

PERS Investment Returns

According to the PERS investment consultants, the plan’s investment performance for FY 2018 was a return on investments of 9.48%, which is above the current actuarial model’s target investment return of 7.75%. This return placed the plan above the median return for its peer group (plans having greater than $10 billion in assets) of 8.89%. 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 14% for each period). Over the past 10 years, the PERS investment return on assets averaged 7.45%. Historically, PERS investment returns have averaged 6.28% over the past 20 years, 7.84% over the past 25 years, and 8.55% over the past 30 years.

Funding Ratio

June 30, 2018, funding ratio: 61.8%

- Increase from 61.1% at end of FY 2017
- Projected 2047 funding ratio of 95.8%

Primarily due to the future increase in the employer contribution rate (effective July 1, 2019), the plan has a projected future funding ratio of 95.8% by 2047, which compares favorably to the assessment metrics in the plan’s new funding policy.

Active Members to Retirees

The ratio of active members to retired members in the PERS plan decreased approximately 36% over the past 10 years.

- FY 2018 ratio: 1.40 active employees for each retired member
- FY 2008 ratio: 2.20 active employees for each retired member

The declining ratio is attributable to a decrease in the number of active members and an increase in the number of retired members.

This decrease results in funding future pension obligations over the payroll of fewer active members. However, the PERS active member to retired member ratio of 1.46:1 at the end of FY 2017 was above the average ratio for other pension plans across the nation.
The PERS actuarial model currently assumes a 3.25% increase in annual payroll.

- FY 2018 payroll decreased 0.65% compared to FY 2017 payroll.
- 5-year average annual payroll increase: 0.60%
- 10-year average annual payroll increase: 0.81%

According to the PERS actuary, payroll growth (either through increases in existing salaries or through the creation of new positions) that is less than expected can cause upward pressure on the amortization period attributed to the unfunded actuarial accrued liability (UAAL). However, the upward pressure on the unfunded actuarial accrued liability may be partially or totally offset due to the decrease in the amount of future liabilities resulting from a lower payroll amount than assumed in the actuarial model.

Highlights of the New Funding Policy

In June 2018, the PERS Board adopted a new funding policy with the following objective:

The objective in requiring employer and member contributions to PERS is to accumulate sufficient assets during a member’s employment to fully finance the benefits a member will receive in retirement.

To accomplish this objective, the board outlined several goals in the funding policy:

- Preserve the defined benefits structure for providing lifetime benefits to the PERS membership,
- Pursue contribution rate stability,
- Maintain an increasing trend in the funded ratio over the projection period with a target of being 100% funded, and
- Require clear reporting and risk analysis by the plan’s actuary using a signal light approach.

Included in the new funding policy are three metrics to track the plan’s progress in achieving the goals and objectives outlined by the PERS Board (funding ratio, cash flow as percentage of assets, and actuarially determined contribution)* and a course of action should any of the metrics fall below certain thresholds. The new metrics will be evaluated through a “signal light” approach (green indicating goals and objectives achieved, yellow warning that future negative actions may lead to a failure in goals and objectives, and red suggesting the PERS Board must consider changes to employer contribution rate).

*The actuarially determined contribution is a calculation of the potential contribution rate necessary to allow the PERS plan to reach its funding goals within a 30-year period under the prescribed methods outlined in the board’s funding policy.

Increase in Employer Contribution Rate

In consideration of results from an annually calculated actuarial valuation under the new funding policy the PERS board raised the employer contribution rate percentage to 17.40% of annual compensation, an increase of 1.65% (effective July 1, 2019). Under the prior measurement system, a rate increase would also have been needed.