PEER MISSISSIPPI
Joint Legislative Committee on Performance Evaluation and Expenditure Review

2022 Update on Financial Soundness of the Public Employees' Retirement System

Report Highlights

May 9, 2023

KEY FINDINGS: As of June 30, 2022, all three of the plan's funding policy metrics reached red signal-light status. Based on these results and the negative investment experience of the plan for FY 2022, the PERS Board voted to adopt the recommendation of its actuary to increase the employer contribution rate from 17.40% to 22.40%, an increase of 5.00%. Additionally, during its June 2022 meeting, the PERS Board, on the recommendation of Callan LLC, adopted changes to the overall asset allocation model utilized by the System to include private credit and private infrastructure.

BACKGROUND

Background

The Public Employee's Retirement System of Mississippi (PERS) is a defined benefit retirement plan for a majority of 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.

The PERS 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 way the Board accomplishes this task is by setting contribution rates for employers participating in the plan. 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 components such 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 PERS plan to maintain financial soundness. Underperformance in any one area can cause additional stress on other components and can lead to underperformance of the PERS plan as a whole.

This report includes information regarding the financial soundness of the PERS plan, as well as information regarding prospective changes in the PERS plan's asset allocation model, including the addition of private credit and private infrastructure investments.

ACTUARIAL SOUNDNESS

The PERS Board, in consultation with its actuaries, develops an actuarial model based on assumptions such as projected investment returns, payroll increases, inflation, retirement ages, mortality rates, marriage rates, and accrued leave to project the plan'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.

- **Over the last 5- and 10-year periods, the PERS actual average annual payroll increase has remained below the actuarial model's projected rate.**
  The projected annual rate of wage increase is 2.65%. While actual wage increases for FY 2022 were above the projected annual rate of wage increase of 2.65%, for the past five fiscal years, the actual average annual payroll increase was 1.36%, and during the past 10 fiscal years the actual average annual payroll increase was 0.98%.

- **The ratio of active to retiree members in the PERS plan decreased from 1.81:1 in FY 2012 to 1.24:1 in FY 2022, or approximately 31.49%.**
  The declining ratio is attributable to a decrease in the number of active members and an increase in the number of retiree members.

- **The PERS Board's investment assumption target is 7.00%. Due to the Board's funding policy, the current investment assumption rate will be reduced over time from its current rate, 7.55%, until it reaches the target rate of 7.00%.**
  PERS Board, at its August 2021 meeting, set the plan's current investment return assumption target at 7.00%. However, due to the plan's funding policy, the PERS plan has only experienced excess returns sufficient to reduce the plan's utilized investment return assumption rate from 7.75% to 7.55%. While PERS's actuary did provide the methodology for assumption changes utilized by the Board in the PERS funding policy, the PERS Board's choice to utilize this methodology could continue to be a cause of concern. Selection of this methodology has delayed implementation of the assumption reduction and exacerbated the plan's lower-than-projected investment returns.

Funding Ratio

For FY 2022, the actuarial value of assets in PERS remained flat in relation to the actuarial value of its liabilities—61.3% for both FY 2021 and FY 2022.

According to projections prepared by PERS's consulting actuary as of June 30, 2022, the plan's funding ratio was projected to be 48.6% by 2047, as compared to 93.5% reported in the FY 2021 projection reports. The decrease in the future funding level is primarily due to less-than-expected investment gains.

Investment Return

For FY 2022, the PERS system had an investment return of -8.54%, which is below the assumed investment rate of return. Because the system did not exceed the expected return, the PERS plan did not make progress in lowering its investment return assumption to the actuarial recommendation in FY 2022. As no progress was made toward the target rate assumption, it is critical that the PERS Board and its actuary continue to monitor this assumption and the experience of the plan. The PERS plan's actuary will evaluate the plan's investment return assumption in the plan's next experience study.

SUSTAINABILITY

The PERS plan's funding policy defines several goals and objectives, including the maintenance of an increasing trend in the plan's funded ratio (over the projection period) with the target of a 100% funding level by 2047.

- **Based on the results of the evaluation metrics in the funding policy as of June 30, 2022, all three of the plan's metrics are at red signal-light status.** One of the plan's funding policy metrics analyzes the plan's projected funded ratio as of FY 2047. For the fiscal year ended June 30, 2022, the plan's projected funding level was 48.6%, decreased from 93.5% for the year ended June 30, 2021.

Metric	Result	Status
Funded Ratio (in FY 2047)	48.6%	Red
Cash Flow as a Percentage of Assets	-7.8%	Red
ADC/FCR Ratio	124.8%	Red

- **In its December 2022 meeting, the Board voted to increase the employer contribution from 17.40% to 22.40%. The prospective date for implementation of this change is July 1, 2024.**
  Based on these results, and the negative investment experience of the plan for FY 2022, the plan's actuary recommended increasing the plan's employer contribution rate. In light of concern expressed by multiple employer groups, the PERS Board voted in its February 2022 meeting to amend the effective date of the prospective rate change to July 1, 2024.

- **As of June 30, 2022, PERS's anticipated accrued liability payment period was 48.8 years, a decrease from 50.9 years as of June 30, 2021.**
  The PERS Board's actuary attributes the decrease primarily to higher-than-expected wage growth experienced by the plan during FY 2022. Higher-than-expected mortality experience also contributed to the reduction in the payment period.

Prospective Changes in Asset Allocation Model for the PERS Plan

- During its June 2022 meeting, the PERS Board, on the recommendation of its investment consultant Callan LLC, adopted changes to the overall asset allocation model utilized by the System to include private credit and private infrastructure.
  - *Private Credit:* Private credit investments are an asset class of privately negotiated loans and debt financing from non-bank lenders (e.g., direct lending, real asset lending).
  - *Private Infrastructure*: Private infrastructure investments are long-lived assets that are essential for the economic productivity of society and facilitate the movement of people, goods, and ideas (e.g., investment in debt related to these types of projects, purchase and operation of existing assets).
- When asked why the PERS Board adopted changes to the plan's asset allocation model, the PERS Board responded:

> *The driving reason for the addition of the new asset classes is that they are expected to provide further diversification to a portfolio heavily weighted in public equities. The benefits that both private credit and infrastructure can provide to the PERS portfolio are (but are not limited to) cash flow generation, expected return premiums, higher downside protection, and volatility dampening.*

For more information, contact: (601) 359-1226 | P.O. Box 1204, Jackson, MS 39215-1204
Representative Jerry Turner, Chair | James F. (Ted) Booth, Executive Director