Providing Benefits for Life

January 25, 2024

Honorable Jason White, *Speaker of the House of Representatives*
Honorable Delbert Hosemann, *Lieutenant Governor*
P.O. Box 108
Jackson, MS 39215

Dear Gentlemen:

Thank you for your interest in the Public Employees' Retirement System of Mississippi (PERS). We appreciate your past support and look forward to working with you in the future. PERS is such a valuable and important system, not only for our membership, but for the state. This is true in terms of the people who are directly affected (at least 10 percent of the state's population) and in terms of the economy for every one of our 82 counties, creating billions of dollars in economic activity every year for Mississippi. Therefore, our combined focus on solutions for maintaining this plan for lifetimes to come is critically important. As state leadership, you have the unenviable task of managing the state's finances and other competing priorities in addition to the obligation of PERS; we greatly respect that and continue to stand with you as willing partners for the betterment of PERS. As such, we offer in this letter several recommendations (*Attachment A – One-Page Summary*) and other considerations.

HISTORY

Financially, PERS is an accumulation of everything that has happened since we were created roughly 70 years ago, referring to every recession, any relevant legislative changes, benefit increases, assumption changes, board decisions, economic expansions, and anything else influencing the PERS financial status. As of our June 30, 2023, valuation, the actuarial funded ratio was around 56 percent (the decrease to 56 percent from 61 percent was largely the result of the change in the assumed rate of return). The other 44 percent represents the unfunded actuarial accrued liability (UAAL or unfunded liability), which is now more than $25 billion. The UAAL is the difference between the actuarial value of assets and the actuarial accrued liability. I reference this because most of the employer contribution rate goes toward paying the UAAL. It is this UAAL that drove the latest employer rate increase, and it will likely be the reason for any future employer rate increases. How did we get here? **In short, the last 25 years have seen additional benefit enhancements placed into law without additional funding at the time, the active member-to-retiree ratio decline, retirees living longer, several economic downturns (including the Great Recession), and a more conservative approach to public pensions in general.** This is not an all-inclusive list, and these factors are not all bad things; but they have had a cost.

RECOMMENDATIONS

The PERS Board voted to recommend several changes in our legislative package for the current 2024 session as follows:

1. **A New Retirement Tier for Future Hires**
   A potential Tier 5 would be **for new hires only** and would be structured like the current PERS Tier 4 except for offering four-year vesting rather than eight, having a reduced member contribution rate, and providing no guaranteed Cost-of-Living Adjustment (COLA). Availability of the COLA in the new tier would be tied to inflation, capped at 3 percent, and based on funding availability. (*Attachment B – Tier 5 Legislative Language).* Included in this recommendation is also language to change the vesting requirement for existing PERS members from eight to four years, which would address past legislative and board interest on the topic. If approved, and unless specific one-time appropriations of approximately $40 million are provided, the additional funding for the vesting change for current members will be reflected in future contribution rates.

   Having a Tier 5 has several potential positive attributes, including a reduced (not eliminated) need for continuing long-term employer rate increases. **However, one main advantage is providing needed flexibility for the next generation of decision makers, especially if we encounter future economic or other adversity. We believe the proposed Tier 5 as drafted lessens the possibility of changes to existing benefits and helps better sustain PERS long term, while maintaining a strong, traditional, defined benefit pension for future teachers, first responders, and other public servants.**

   Although having a Tier 5 has several advantages, please remember that it is a longer-term solution and does not address the current UAAL, nor does it eliminate the consideration of raising the employer contribution rate in the short term.

2. **Limit Employer Match for New Optional Retirement Plan Participants**
   Next, we recommend changes to the Optional Retirement Plan (ORP), a defined contribution plan that only pertains to certain administrator and faculty positions within the Institutions of Higher Learning (IHL). Under current law created years ago, the participants' match is tied to the PERS employer contribution rate. The PERS rate has increased substantially due to the UAAL, but this, in turn, has increased the rates contributed by employers to ORP participant accounts. With our proposed legislation, contribution rates for both employer and participants will remain tied to the PERS rates, but the employer contribution allocation for ORP participants will be limited and all remaining contributions will be applied to the PERS UAAL. The proposal would add a new tier to ORP that would cap the employer contribution to the participant's account at 9 percent of compensation, with the remaining contributions applied to the UAAL. Finally, the proposal would allow for the possibility of fewer third-party administrators, potentially increasing efficiency and passing on cost savings to the participants. *(Attachment C – ORP Legislative Language).*

3. **Moving to a Monthly Cost-of-Living Adjustment for New Retirees**
   We also recommend the *default* option for the additional annual benefit, commonly referred to as the Cost-of-Living Adjustment (COLA), be changed from an annual lump sum to monthly for future retirees. *(Attachment D – Monthly Default Legislative Language).* **To be clear, this change is not a reduction in benefit; future retirees in tiers 1-4 will receive a COLA under this proposal and it**

will reserve the same amount of COLA the retiree is currently entitled to receive. This recommendation would simply change the default option at retirement for future retirees; they would still be able to opt for the lump sum at retirement if they choose.

4. **Require the Payment of the Unfunded Actuarial Accrued Liability (UAAL)**
   Should a covered employer be sold, dissolved, or terminated from PERS for any reason, the terminating employer should be required to pay its proportionate share of the UAAL. If not, the remaining employers, and ultimately the system and the state, are left to cover the cost. *(Attachment E – UAAL Payment Legislative Language).* This recommendation would address this issue.

5. **Changes in the Mississippi Deferred Compensation Program**
   Recommended changes here are being proposed to comply with recent changes in federal law by providing for ROTH (after-tax) catch-up contributions. Separately, we propose making allowances for Qualified Domestic Relations Orders (QDROs) in the MDC program. *(Attachment F – MDC Legislative Language).*

FUNDING REQUESTS

In addition to the proposed legislative changes, we respectfully request consideration of additional funding, cash infusion, direct appropriations for the past benefit increases, or any other amount the state deems appropriate and feasible. Please also consider the possibility of any new revenue streams or a dedicated revenue for PERS. Similarly, many states have recently used a portion of their surplus funds to make additional payments to their retirement system(s) in some manner. *(Attachment G – Selected States Appropriating Funds above the ADEC to Public Pension Plans since FY 21).* Also, Louisiana recently passed a ballot measure increasing the minimum up to 25 percent of surplus dollars to be applied to the UAAL of its pension systems. We realize there are many competing priorities for state dollars, but we would be remiss if we did not communicate the cost and needs of PERS, which is also part of the state's financial apparatus. Any amount the state may choose to fund, especially on a recurring basis, would be greatly appreciated; could help mitigate the need for benefit changes; and may help local governments or possibly offset the increases in the employer rate.

OTHER CONSIDERATIONS

Increased Employer Contributions and Assumed Rate of Return

The PERS Board of Trustees has increased the employer contribution rate to 22.40 percent, phasing it in at only 2 percent each year starting July 1, 2024. Under this board action, this equates to a 2 percent increase July 1, 2024; another 2 percent increase July 1, 2025; and an additional 1 percent increase July 1, 2026; up to the total employer rate of 22.40 percent. Separately, the Board has lowered the plan's assumed rate of return from 7.55 percent to 7 percent based on the recommendations of the actuary and others. A reasonable and appropriate assumption is important to avoid understating the liabilities and underfunding the plan. The lower assumption increases contributions, thereby helping cash flow and reducing some of the risk that comes with relying on volatile investments, which are needed to meet our long-term liabilities. We also better position ourselves in the future for actuarial gains, as opposed to actuarial losses, with respect to the investment return assumption. It is also important to appropriately price a potential Tier 5 with proper assumptions. **As anticipated with the lower investment assumption, the actuaries have recommended we continue to phase in the employer contribution rate increases at 2 percent each fiscal year until we reach 27.40 percent. However, the Board has taken no action on this new recommendation and may not choose to act until the 22.40 percent employer rate is fully implemented.**

Funding Method for Employer Contributions
We believe continuing the current percent-of-payroll method as the primary funding mechanism is likely the most efficient and appropriate approach to fund the pension system currently. This process essentially allows the state and other employers to fund the system justifiably using special, federal, or other dollars tied to federal, local, or special fund positions. This is why Mississippi and many other states use this method. **Also, importantly, we have previously estimated that less than one-third of the overall employer contributions to PERS come from state general funds.** Historically, employer contributions for state agencies, public schools, community colleges, and institutions of higher learning have made up a relatively small percentage (approximately 5 percent) of total state expenditures. *(Attachment H – PERS Facts and Figures, Page 19).*

Nature of a State-Sponsored Defined Benefit Plan
Some of the questions, concerns, or challenges around PERS largely relate to the nature of a state-sponsored defined benefit pension plan where the state and system absorb the risk. But having a defined benefit plan is how we can provide the guaranteed benefit for life to all retired teachers, nurses, firefighters, police officers, social workers, sanitation workers, cafeteria workers, coaches, elected officials, and others who spent their careers in public service. Defined benefit plans are intentionally designed with this in mind. The overall formula for a public pension is:

Contributions + **I**nvestments = **B**enefits + **E**xpenses

Administrative expenses are relatively small in the grand context of PERS; benefits are set in law; and investments can be well managed but still carry risk (and are not guaranteed to always produce the needed returns). This just leaves contributions as the manageable lever for change. Because of these factors, it is not uncommon for a level of tension to develop between PERS as the plan's fiduciary with a legal and ethical obligation solely to the best interest of the membership and the Legislature as the plan sponsor with obligations to the general citizenry and taxpayer (both societal segments that also include PERS members). This tension could be even more common with a maturing system like PERS. As we have grown over the years, so have our dollar amounts, retiree counts, and projected liabilities.

Declining PERS Active Membership
Please be mindful that any initiatives, regardless of merit, that decrease the number of active, contributing PERS members will likely have a negative effect on PERS' financial condition. Over the last 10 years alone, the number of active members has decreased by approximately 10 percent and several initiatives have created the opportunity or incentive for future employees to avoid PERS altogether. This loss of membership typically has a negative impact on the system, and it spreads the cost of funding the plan across a smaller base of remaining contributing employees.

Long-Term Sustainability
PERS is certainly stable; but we must work together to keep it that way. Retirees and members can count on their retirement, as we have more than $30 billion at present to pay benefits. **There is no need for immediate alarm.** Also, existing retirees presently make up the largest portion of the actuarial accrued liabilities and, although projected to increase in the short-term, this retiree liability is currently estimated to begin slowly decreasing after 2036.

However, when it comes down to the long-term sustainability of PERS, we should either fund it, change it, or eventually we may risk it. Revenue must increase, expenses and liabilities should decrease, or both. In other words, we need to raise the employer contribution rate or cut the benefits.

We should continue this very frank and realistic discussion when it comes to contribution rates, new tiers, funding, or other possible changes. Part of our job is to be transparent and communicate the needs and cost of the plan on behalf of the system.

Additional Information and Analysis
We support the proposed changes and requested funding listed in this letter. However, if funding is not available, contribution rates are capped, or employer contribution rates are not increased to the appropriate level, the Board has discussed how current benefits may need future modification based on actuarial necessity to maintain the fiscal integrity of the plan. In response to legislative requests and inquiries, we note that temporarily pausing the growth of future COLAs, lowering the percentage rates of future COLAs (temporarily or permanently), changing future COLAs to simple rather than compounding, or making other similar changes has a considerable impact on the projected unfunded liabilities. **These concepts or any others may face political challenges, and any legal challenges (as well as any relevant federal laws) must be considered.** An analysis of making changes in lieu of continuing to raise the employer rate is attached. *(Attachment I – Benefit Scenarios in Lieu of Increased Employer Contributions).*

Teamwork
I believe we must work together on solutions. We understand the importance of considering all stakeholders, including retirees, cities, and others. However, PERS also understands that the roles of the system and Legislature are clear and different from other stakeholders. PERS must hold in trust the funds for the exclusive benefit of **all** members. In turn, the state is obligated as the sponsor of the plan, and we should work together to manage such a large and important endeavor.

In conclusion, please know that PERS board members are very well informed, engaged, and care deeply about PERS and this situation. They are also very sympathetic to the impact changes to PERS have on the state, employers, and local government. By making these recommendations and increasing the employer contribution rate, we are fulfilling our duty as fiduciaries to all the PERS membership (active members, inactive members, retirees, and beneficiaries) and carrying out PERS' responsibilities currently outlined in statute.

Most of these suggestions, or other similar changes, will require an act of the Legislature for implementation. Please know that we are always available as a resource and to partner with you on the above, as well as on any other ideas, recommendations, or solutions you may have. **We support the continuation and sustainability of PERS** and are eager to work with you this session. If I can be of further assistance, please let me know. Thank you.

Sincerely,

H. Ray Higgins, Jr.
Executive Director