



Attn: PERS Study Commission

Written Statement of Dr. Jameson Taylor
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Mississippi's Public Employees' Retirement System (PERS) is carrying billions in unfunded liabilities, such that the state will not be able to offer the current level of benefits to future state retirees without a significant increase in contributions or a change in the benefit structure. As state policymakers work to resolve this crisis, the following three goals should guide their deliberations:

- 1) *Increase accuracy and transparency in reporting the expected investment returns and long-term liabilities of the system.* State employees – and state taxpayers – deserve to know the true status of the state's pension system. In addition to the current safeguards, the state should annually audit PERS using private sector accounting metrics. In particular, PERS should indicate when its presumed rate of return of 8 percent has not been met and how this has impacted cumulative liabilities, as calculated by market value standards.
- 2) *Give all taxpayers a seat at the table.* Taxpayers – the true employers of public employees – should have equal oversight and management of PERS. The membership of the PERS' board of trustees should be changed to require an equal number of plan participants (employees) and non-participants (employers).
- 3) *Cut costs for taxpayers and protect core services.* Mississippi's constitution stipulates that new retirement benefits be fully funded, or at least funded using accepted actuarial standards. Yet PERS' current liabilities are so large that accepted standards project that PERS will again have to be bailed out by increasing employer contribution rates over the next few years. These increased costs, if borne solely by the employer (meaning: taxpayers), will eventually translate into higher taxes and cuts to core services. A better option is to reduce the taxpayer-employer contribution rate while adopting reforms aimed at reducing PERS' unfunded liabilities.

Transparency

The Mississippi Center for Public Policy (MCP) has long advocated for more transparency in government, at both the state and local level – in particular via our website SeeTheSpending.org. In the interest of transparency, state leaders must have a realistic discussion with state employees and other taxpayers about the actual financial status of the state's pension system. This conversation should be focused on facts, avoiding optimistic hopes based on unrealistic returns while also rejecting pessimism regarding the current economic downturn. In short, it should be a

conversation based on sound fiscal principles, such as those employed by a certified financial planner advising a client in the private sector.

This dialogue should begin by evaluating whether the plan's 8 percent presumed rate of return is financially prudent.

- As recommended by the Employment Retirement Security Act (ERISA) private sector pension plans should presume an annual rate of return no greater than 6.1 percent.
- In today's current financial environment, many financial planners are more likely to assume an even lower return rate of 4 percent to 5 percent.
- Similarly, analysts are increasingly recommending that private sector pension plans invest in bonds, as opposed to equities, in particular owing to savings obtained from lower taxes and management fees (cf. "[Gentlemen Prefer Bonds](#)," *Journal of Applied Corporate Finance*). Such debt instruments have a lower rate of return, but also much lower risk.
- The current yield on a 30-year Treasury bond is approximately 3.34 percent. Meanwhile, year-to-date returns for the S&P 500 are *negative* 6.39 percent.

Yet, PERS' current investment strategy is to achieve a return of 8 percent "with the lowest possible risk." It is not at all clear how this goal can be attained. If this 8 percent return rate is not met, the unfunded accrued liability of the state's pension plans will be much larger than currently reported.

The FY2010 PERS Comprehensive Annual Financial Report indicated that the system was carrying an unfunded cumulative liability of \$11.3 billion. This is more than double the state's entire General Fund estimated revenue for FY2012. But this calculated liability assumes an 8 percent rate of return.

A return rate based on the market value of liabilities (MVL) for PERS yields a much higher unfunded liability. The MVL is the required benchmark used for calculating corporate pension plan liabilities. Using an MVL rate based on the return from Treasury securities reveals that PERS had an unfunded liability of \$51.8 billion as of December 2008, according to a [2009 study](#) in the *Journal of Economic Perspectives*. This real-market liability of \$52 billion represents more than 40 percent of gross state product and is more than 10 times anticipated General Fund revenue for FY2012. More concretely, according to a [subsequent study](#) by the same economists, fully funding PERS using a 30-year amortization period would result in a \$1,127 tax increase per year for every Mississippi household over the next 30 years.

Current law (§ 25-11-119) requires an annual audit by the State Auditor's Office and also requires an actuarial survey every two years. In the interest of improving transparency, we

recommend the state crosscheck its public sector (GASB) audits using the same methodology and standards that would be used to audit a pension in the private sector. In particular, PERS should use a standard that employs the market value of liabilities (MVL) to calculate its unfunded liabilities.

Under current GASB standards, PERS' liabilities are discounted using the 8 percent expected return rate. But this rate is in no way guaranteed and so is not an accurate measure of actual liabilities. An MVL rate, however, correlates liabilities against investment risk. This is particularly prudent in light of the fact that pension benefits are generally considered to be a guaranteed payment to retirees. From a market perspective, this means that investment vehicles used to sustain PERS should also be low risk. Using an MVL standard, though, would translate into a lower anticipated rate of return and thus a higher unfunded liability.

State retirees – and other taxpayers – deserve to know the true status of their pension plan. For this reason, we recommend the following reforms:

- 1) Annually audit PERS using private sector accounting metrics that would apply to private sector pension plans. This audit should be conducted by an independent firm chosen by the governor (as opposed to the PERS board or the state auditor).
- 2) Provide the results of this private sector accounting audit to all pension plan participants in the form of a one page summary that clearly identifies current rates of return and projects unfunded liabilities using the market valuation of liabilities – that is, the standard used in private sector pension plans. This summary should include a calculation of how much it would cost per household to amortize any unfunded liabilities over 7 years (the standard used in the private sector), as well as over 30 years (the allowable maximum in the public sector). The summary should be posted on the PERS' website so that all taxpayers can access it.

Change the Structure of the PERS' Board

The PERS' board of trustees is made up entirely of participants in the state's pension plans. Other taxpayers are not represented at all. Yet, the board holds the power to invest all assets held by the plan and to choose the system's executive director. In particular, while the legislature is responsible for setting the employee contribution rate, the board holds the power to set the employer contribution rate for PERS. **In the private sector, this would be the equivalent of allowing employees to set the employer contribution rate for their 401(k), without any input from management.** The difference here is that taxpayers are the true employers and thus responsible for paying the employer contribution.

A fairer option would give all taxpayers a voice on the PERS' board. In order to address this fundamental inequity, we recommend the following reforms:

- Require the board to maintain equal representation of beneficiaries and non-beneficiaries – that is, employees and taxpayer-employers.
- Require at least 1 member of the PERS’ board to be a certified financial planner with expertise in retirement planning.
- Require at least 1 member of the PERS’ board to be a private sector actuary.
- Remove the power held by the PERS’ board to set employer contribution rates, leaving that responsibility solely with the legislature.

Cut Taxpayer Costs and Protect Core Services

Mississippi’s constitution forbids increasing pension benefits without available funding, as dictated by § 272A (2):

Legislation shall not be enacted increasing benefits under the Public Employees’ Retirement System of Mississippi and the Mississippi Highway Safety Patrol Retirement System in any manner unless funds are available therefor, or unless concurrent provisions are made for funding any such increase in accordance with a prior certification of the cost by the board of trustees of the systems based on accepted actuarial standards.

While the nuances of this constitutional guidance may be debated, the intent is clear – the creation of a retirement system that does not amass unsustainable unfunded liabilities. In essence, PERS is attempting to remain actuarially sound by increasing taxpayer contribution rates – to a projected 14.35 percent over the next two years. **This represents an 11 percent increase over and above the current rate of 12.93 percent.** It is also 60 percent higher than the member contribution rate of 9 percent.

Increasing taxpayer costs by 11 percent is not a sustainable plan. Instead, policymakers must pursue reforms aimed at reigning in skyrocketing costs. These include:

- Restoring retirement benefits to the level in place at the time of employment for employees who have not yet accrued 25 years of service. This reform is particularly necessary given that the retroactive application of the 1999 benefit increase is one of the primary reasons for the system’s unsustainable liabilities.
- Capping state and local hiring for non-essential positions until PERS’ unfunded liabilities fall back down to accepted standards.
- Eliminating the “double-dipping” practice of drawing a state retirement while continuing to serve a state or local government as a contractor.



As explained above, taxpayers and PERS participants also deserve a full accounting of PERS' liabilities and should be provided with a statement indicating what the cost per household would be to fully fund PERS according to both public sector and private sector benchmarks.

Limited Government is the Answer

Finally, it is worth considering that the long-term reason the state's pension liabilities keep growing is because state and local government keeps growing as a share of the state's economy.

- Over the past five years, total government employment in Mississippi increased by 3.3 percent. During the same period, total nonfarm employment declined by almost 4 percent.
- Likewise, the total state budget went from \$14.3 billion in FY2007 to \$18.9 billion for FY2012, an increase of 32 percent.

As long as state and local government keeps expanding – and expanding faster than the private sector – funding obligations for the state pension plan will continue to grow. Reforming the system to increase transparency and reduce unfunded liabilities will not only place PERS on a sound fiscal footing, but also prevent shifting costs to future taxpayers.

Thank you for your time. Any questions may be addressed to me at taylor@mspolicy.org or by calling 601-969-1300.