Claire McCaskill

Missouri State Auditor

January 2006

Missouri State Employees' Retirement System

Four Years Ended June 30, 2004

Report No. 2006-02

Office Of The
State Auditor Of Missouri
Claire McCaskill

January 2006

YELLOW SHEET

The following items were noted as a result of an audit conducted by our office of the Missouri State Employees' Retirement System.

In fiscal year 2005, the retirement system board began providing its employees the same guaranteed annual cost of living adjustments (COLA) as provided to system retirees and survivors. Fiscal year 2005 COLA increases, which totaled approximately $56,000, were less than the state pay plan. In years when the state pay plan provides no, or smaller, COLA increases, the new policy may provide raises to Missouri State Employees' Retirement System (MOSERS) employees significantly higher than available to all other state employees. Additionally, once every two years the board adjusts salaries based on a salary survey conducted by MOSERS employees. The 2004 salary survey process provided for total annual increased compensation of approximately $78,500 for 28 employees, effective January 1, 2005. The next salary survey is to be performed in 2006.

The board also provides its employees with significant potential annual performance incentive payments which are generally not available to other state employees. If the retirement fund performance benchmarks are met or exceeded, the Chief Investment Officer and investment section employees are eligible for various incentive amounts based on quantitative and/or qualitative measures. For example, the Chief Investment Officer's employment contract provides for an annual incentive payment of 30 percent of base pay in addition to the incentive payment received under the investment employees incentive program. Effective in fiscal year 2005, the board implemented an incentive compensation program for all other staff, based on various other quantitative and qualitative measures. Additionally, the Executive Director's employment contract, effective March 2004, provides for an annual incentive payment up to $20,000 as determined by the Board of Trustees. In his response to the audit recommendations, MOSERS' Executive Director stated "the pay plan was designed to attract and retain the high caliber talent needed to effectively and efficiently administer a multi-billion dollar pension plan" and cited information regarding MOSERS' investment and operational performance. The complete response is included in the audit report.

MOSERS spent approximately $314,000, $311,000, $275,000, and $363,000 on travel and meeting expenses during fiscal years 2004, 2003, 2002, and 2001. Although the board has established travel policies, the policies do not provide limits on the amounts that will be reimbursed for certain travel expenses. The board also has not established a system for reporting travel expenses and gifts that board members and employees have accepted from third parties. Accepting meal expenses or other gifts, including those allowed by MOSERS current policy, from entities which MOSERS contracts with or could potentially contract with could give the appearance of a conflict of interest.

MISSOURI STATE EMPLOYEES'
RETIREMENT SYSTEM

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CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Matt Blunt, Governor
and
Board of Trustees
and
Gary Findlay, Executive Director
Missouri State Employees' Retirement System
Jefferson City, MO 65109

The State Auditor is required under Section 104.480.4, RSMo 2000, to review the audits of the Missouri State Employees' Retirement System. The system engaged KPMG, LLP, Certified Public Accountants (CPAs), to audit the system's financial statements for the years ended June 30, 2004, 2003, 2002, and 2001. We reviewed the reports and substantiating working papers of the CPA firm. The scope of our review included, but was not necessarily limited to, the years ended June 30, 2004, 2003, 2002, and 2001. The objectives of this review were to:

1. Review compliance with certain legal provisions.

2. Evaluate the economy and efficiency of certain management practices and operations.

Our methodology to accomplish these objectives included reviewing minutes of meetings, written policies, financial records, and other pertinent documents; interviewing various personnel of the system, as well as certain external parties; testing selected transactions; and analyzing comparative data obtained from the system.

In addition, we obtained an understanding of internal controls significant to the review objectives and considered whether specific controls have been properly designed and placed in operation. We also performed tests of certain controls to obtain evidence regarding the effectiveness of their design and operation. However, providing an opinion on internal controls was not an objective of our procedures and accordingly, we do not express such an opinion.

We also obtained an understanding of legal provisions significant to the review objectives, and we assessed the risk that illegal acts, including fraud, and violations of contract, grant agreement, or other legal provisions could occur. Based on that risk assessment, we

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designed and performed procedures to provide reasonable assurance of detecting significant instances of noncompliance with the provisions. However, providing an opinion on compliance with those provisions was not an objective of our procedures and accordingly, we do not express such an opinion.

Our review was conducted in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such procedures as we considered necessary in the circumstances.

The accompanying History, Organization, and Statistical Information is presented for informational purposes. This information was obtained from the system's management and was not subjected to the procedures applied in the review of the system.

The accompanying Management Advisory Report presents our findings arising from our review of the Missouri State Employees' Retirement System.

Claire McCaskill
State Auditor

April 29, 2005 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
Audit Manager:	Douglas J. Porting, CPA
In-Charge Auditor:	Kim Spraggs, CPA

MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

1. Salary Issues

Despite recent state budget constraints, Missouri State Employees' Retirement System's (MOSERS) Board of Trustees (board) has provided its employees significant pay raises and lump-sum payments beyond cost of living adjustments (COLA) given to other state employees.

During the past several years, the board has provided various types of pay raises and incentive payments to its employees:

- Prior to fiscal year 2005, the board provided its employees with the same COLA increases as other state employees were given. Beginning in fiscal year 2005, the board adopted a new employee compensation and benefits policy, providing its employees with the same guaranteed annual COLA as provided to system retirees and survivors. MOSERS employees, with the exception of the Executive Director and the Chief Investment Officer, now receive an annual COLA equal to 80 percent of the increase in the consumer price index, subject to a maximum of 5 percent of pay. Fiscal year 2005 COLA increases totaled approximately $56,000 while the $1,200 annual COLA increase available to other state employees under the state pay plan would have provided approximately $82,000. However, in years such as fiscal year 2006 when the state pay plan provides no, or smaller, COLA increases, the new policy may provide raises to MOSERS employees significantly higher than available to all other state employees.

  In addition to the COLA increases mentioned above, once every two years the board adjusts salaries based on a salary survey conducted by MOSERS employees. The survey participants are generally other statewide public employee or teacher retirement systems, including some other Missouri systems and systems from other states. The 2004 salary survey process provided for total annual increased compensation of approximately $78,500 for 28 employees, effective January 1, 2005. The 2002 salary survey process provided for a total annual increased compensation in the amount of approximately $37,000 for 21 operations employees, effective July 1, 2003. A salary survey conducted for investment staff in 2002 and an investments section reorganization during fiscal year 2003 resulted in five investments section staff receiving annual increased compensation totaling $48,000 effective December 2002 and January 2003. Under current board policy, the next salary survey will be performed in 2006.

- The board provides its employees with significant annual incentive payments. The investment section employees' incentive program provides for an annual incentive pool for payment to all investment section employees, other than the investment operations employees, of up to 20 percent of the employee's base pay if retirement fund performance benchmarks are met. If fund performance benchmarks are not met, no incentive pool is available. When distributing the incentive pool money, each investment employee, other than the investment operations employees, automatically receives 50 percent of his or her applicable incentive award. The other 50 percent of the award is based on a qualitative evaluation of the achievement of the system goals and dedication to overall enhancement of the investment program, as determined by the Chief Investment Officer.

Also, if retirement fund performance benchmarks are met, an amount equaling ten percent of the total incentive pool payments distributed to the investment section employees is set aside in an incentive pool for investment operations employees. Each investment operations employee is eligible to receive a prorated share of the investment operations incentive pool based on the percentage his or her salary represents of the total investment operations employees' salaries. The incentive payment earned is based 100 percent on the same qualitative evaluation used by the Chief Investment Officer for the other investment staff.

In addition, effective in fiscal year 2005, the board implemented an incentive compensation program for all other staff (operations staff). Under this program, all other staff may receive incentive payments up to 10 percent of their base pay based on various quantitative and qualitative measures. An employee may receive 4 percent of his or her base pay for accomplishment of MOSERS' overall performance objectives as measured by an outside entity, and up to 6 percent of his or her base pay for accomplishment of individual performance objectives as evaluated by their supervisor. The first incentive payments under this program were planned for June 2005.

The Executive Director's employment contract, effective March 2004, provides for an annual incentive payment up to $20,000 as determined by the Board of Trustees. If the retirement fund performance benchmarks are met, the Chief Investment Officer's employment contract, effective February 2004, provides for an annual incentive payment of 30 percent of base pay in addition to the incentive payment received under the investment employees incentive program discussed above.

Incentive payments relating to calendar years 2002, 2003, and 2004 are summarized below:

Table I: Incentive Payments				
		Year Ended December 31,		
Employee(s)		**2004**	**2003**	**2002**
Executive Director (1)	$	18,000	N/A	N/A
Chief Investment Officer (1)		91,200	27,000	27,000
Investment staff (2)		78,400	75,000	58,860
Total Incentive Payments	$	187,600	102,000	85,860

Source: MOSERS calculations.

(1) The Executive Director and Chief Investment Officer began receiving contracted incentives in 2004. The Chief Investment Officer's contracted incentive amount was $57,000 for 2004.
(2) There were eight investment staff in 2004 and 2002, and seven investment staff in 2003.

The raises and payments the board provided its employees, with the exception of the COLA increases prior to fiscal year 2005, have generally not been available to other state employees. Although Section 104.500, RSMo 2000 gives the board exclusive jurisdiction to set employee compensation, Section 104.460, RSMO 2000 also defines MOSERS employees as state employees. MOSERS officials have indicated they consider MOSERS staff to be state employees for the purpose of eligibility for employee benefits only and they believe the pay increases and lump sum payments have been necessary to maintain high levels of fund performance and customer service, and to retain quality staff. Given the fact that other state employees have generally not received such pay increases and do not receive incentive payments, the board should reevaluate the necessity of such raises and payments.

WE RECOMMEND MOSERS' Board of Trustees review the various compensation programs and reconsider providing future pay increases over and above those provided to all other state employees.

AUDITEE'S RESPONSE

The Executive Director provided the following response:

The members of the board of trustees, in their capacity as fiduciaries, have been given statutory authority to fix the compensation of staff. The applicable statutes read as follows:

> *Section 104.460.4 RSMo - Employees of the system shall receive such salaries as shall be fixed by the board and their necessary travel expense within and without the state as shall be authorized by the board.*
>
> *Section 104.500.5 RSMo - Subject to the provisions of the constitution and sections 104.010 and 104.320 to 104.800, the board of trustees shall have exclusive jurisdiction and control over the funds and property of the system and may employ and fix the compensation of necessary employees.*

The board members have acted as responsible fiduciaries and exercised their authority in establishing a pay plan that addresses COLAs, salary adjustments if supported by biennial salary surveys, and incentive compensation. The SAO concluded that the pay plan should be reconsidered because it differs from the pay plan applicable to other state employees. The pay plan was designed to attract and retain the high caliber talent needed to effectively and efficiently administer a multi-billion dollar pension plan. In that regard, the Attorney General had this to say (in the context of the board's authority to determine travel expenses):

> *"the duties of MOSERS employees are highly complex and technical, requiring familiarity with the intricacies of the financial world and an ability to react quickly to financial events….We believe that the General Assembly acknowledged the realities of MOSERS management needs by its passage of §104.460.4 …. Clearly the MOSERS Board of Trustees is in the best position to determine the proper limits of travel expenses for MOSERS employees." This opinion can be found by referring to Mo. Atty. Gen. Op. No. 99 (1982).*

The pay plan is based on solid business fundamentals:

1. *It establishes salary levels based on market analysis.*
2. *It provides a COLA to help ensure that salaries stay at or near market over periods of time.*
3. *It rewards performance based on results.*

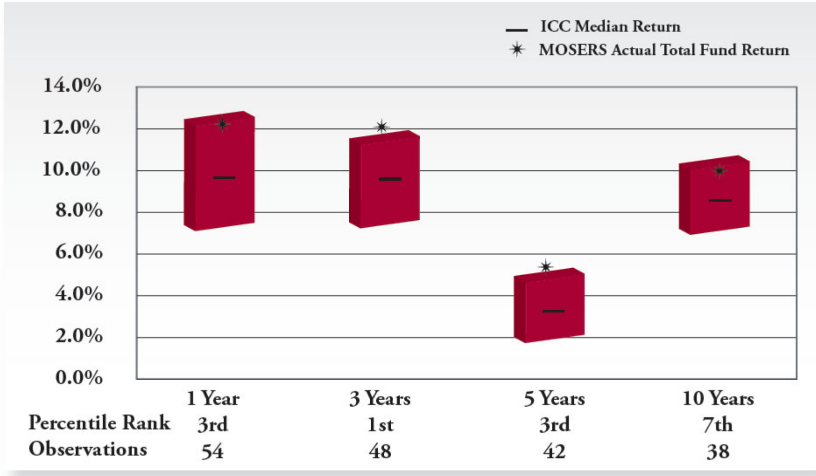
The board has made reasonable policy decisions in establishing a pay plan for staff based on the broad statutory authority established by the General Assembly.

We believe that the real question being asked by the State Auditor is simply this. "Are the members of the system and the taxpayers who support the system getting value for what is being spent?" To me, the proof is in the results, which I believe you were remiss in not including in your report but which I will address momentarily.

The bottom line is that we have saved the taxpayers hundreds of millions of dollars relative to the median performance of the public retirement fund universe and have provided the highest level of customer service at below median industry costs. Our staff turnover is a small fraction of what is being experienced in state government generally. In my opinion, our ability to attract and retain the talent that has produced these results is a direct function of our pay plan – a plan that serves as a model for stellar performance and cost effective service delivery.

<u>Investment Performance</u>

For the past three and five year periods ending June 30, 2005, MOSERS had either the highest or near the highest annualized rates of return in a universe consisting of the largest and most sophisticated public retirement funds around the country. The following chart illustrates this point:



*The chart above provides information from a peer group of public pension funds as tabulated by the Independent Consultants Cooperative (ICC). The red boxes illustrate the range of investment returns. MOSERS return for FY 2005, was 12.6%.

This translates into real dollars and cents. Relative to the median investment performance of public retirement funds (funds with over $1 billion in assets), MOSERS performance over the past five years has resulted in an additional $658 million of income. That is $658 million in additional pension fund income for our members and retirees and $658 million that the taxpayers will not be required to pay in the form of additional contributions made by the state to the system.

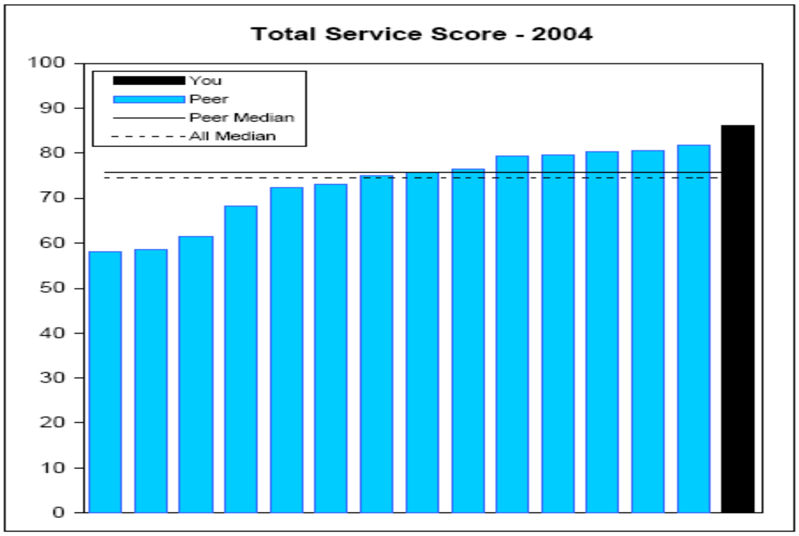
Defined benefit pension funding is really a simple equation:

*Benefit Payments + **Administrative Costs** = **Investment Income** + Contribution Income*

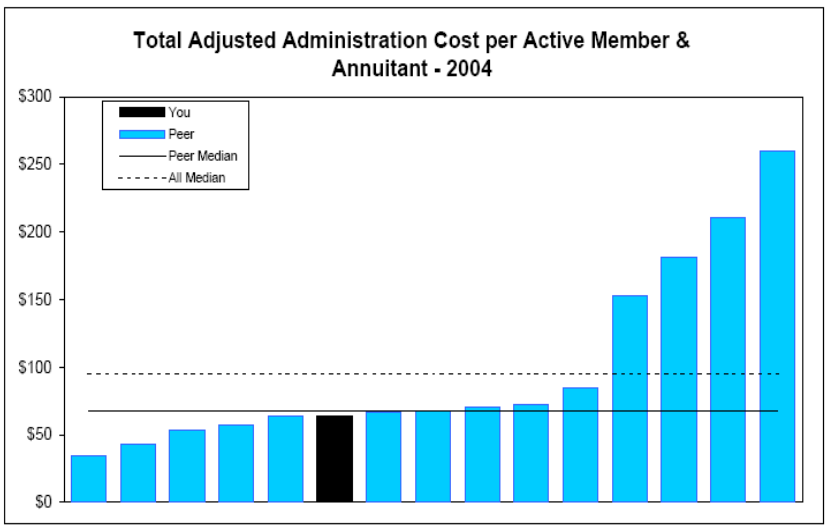
As one can see, if investment income increases, contribution income can decrease and the equation will remain in balance. I addressed "investment income" above, and I will address "administrative costs" next.

Operational Performance

*In order to determine whether or not we are using our resources efficiently, we contract with a firm to compare our administrative costs to the costs incurred by other public pension funds. Based on an independent evaluation by the firm, Cost Effectiveness Measurement (CEM), MOSERS has been judged as having the **highest** level of customer service in our peer group (15 public pension funds) at **below** median cost. The following tables, prepared by CEM, illustrates these points:*



Note: Service score is calculated by CEM and provides a numeric grade on issues such as prompt payment of benefits, counseling, financial control, and service to employers.



Note: Administration cost represents all costs to operate MOSERS excluding any investment related costs.

This is particularly noteworthy considering that most of the plans in our peer group are substantially larger than MOSERS. In fact, MOSERS is the fourth smallest in the peer group. This means that we do not have the benefit of the economies of scale of the others in our peer group. Logically, this would push our cost above median rather than below median.

The service level speaks to the dedication of our employees in providing the highest quality of service possible, and the cost (at below median level) speaks to the efficiency in using pension fund resources (tax payer dollars) wisely.

2. Travel Expense Limits

The board has not established limits for travel expenses, such as lodging and meals. MOSERS spent approximately $314,000, $311,000, $275,000, and $363,000 on travel and meeting expenses during fiscal years 2004, 2003, 2002, and 2001.

We reviewed 14 employee and board member expense reports paid during fiscal year 2004. We noted several instances where lodging or meal reimbursements appeared excessive. In two instances lodging costs related to due diligence monitoring visits were over the federal per diem lodging rate. The Office of Administration has adopted the per diem rates established by the federal General Services Administration as guidelines for state employee travel. The charges for one night's lodging in Los Angeles and Memphis were $175 and $109, respectively, which exceeded the federal per diem rates for these cities by $69 and $28, respectively. MOSERS personnel indicated for the Los Angeles trip, the employee stayed at a hotel in a centralized location of the three money managers being monitored; however, the details supporting this justification were not documented. For the Memphis trip, MOSERS personnel could not provide an explanation of why the employee chose to stay at a hotel at this rate.

We also noted three instances when reimbursements for meal expenses were over the federal per diem meal rate. We noted reimbursements for lunch of $29 and $17, which exceeded the applicable federal rate of $11 and $12; and a dinner of $30, which exceeded the federal rate of $26.

Although the board has established travel policies, the policies do not provide limits on the amounts that will be reimbursed for certain travel expenses. The board should adopt reasonable lodging and meal rates and require a written explanation when costs are claimed that exceed these rates.

WE RECOMMEND the Board of Trustees adopt reasonable lodging and meal rates and require a written explanation as to any reasons necessitating costs which exceed these rates.

AUDITEE'S RESPONSE

The Executive Director provided the following response:

The board of trustees has been given statutory authority to control the salaries and travel expenses of the staff members. The applicable statute reads as follows:

> *Section 104.460.4 RSMo - Employees of the system shall receive such salaries as shall be fixed by the board and their necessary travel expense within and without the state as shall be authorized by the board.*

The authority of the board of trustees to set the travel expense policies for staff is also supported by the opinion issued by the Attorney General cited earlier in which the Attorney General discussed the justification for operational differences between MOSERS and the executive branch in the context of travel regulations.

Although our travel policy clearly states that all expenses must be approved by a supervisor, which implies that some level of reasonableness test was applied, we have initiated a change in our travel policy based on the State Auditor's recommendation. The travel policy will stipulate that hotels and meals must be held to a reasonable level, based on the location of the travel. Any deviations from these new limits will have to be documented on the travel expense reimbursement form and, therefore, subject to supervisory approval. As a practical matter, this step simply represents documenting what has been common practice.

3. Acceptance of Gifts from Third Parties

MOSERS officials indicated, and our follow up on expense reports confirmed, that board members and employees periodically receive paid travel expenses (i.e. meals, lodging, and conference fees) from investment managers while attending conferences or conducting monitoring reviews. The board has not established a system for reporting and monitoring gifts that board members and employees have accepted from third parties, such as investment managers or other vendors which do business with retirement systems.

Our review of 14 expense reports found many instances where certain travel expenses were not claimed for overnight trips taken, and there was no documentation indicating how these expenses were paid (i.e. included in conference registration or lodging fees, or paid for by a third party). In response to our inquiries, MOSERS employees indicated many of the expenses were paid for by third parties. In some cases, MOSERS employees were not able to clearly tell us who paid the expenses.

The board's conflict of interest policy allows employees to accept the following items from third parties:

1) an item or service valued at less than $50
2) food
3) beverages
4) admission to social, art, or sporting events and activities
5) travel expenses to attend educational conferences
6) travel expenses and honorarium paid to an employee who provides educational services/information to a public pension fund, national pension fund organization, or a nonprofit organization
7) informational material
8) other gifts, as long as the total of such gifts does not exceed $200 per calendar year

Section 104.500, RSMo 2000 states that any trustee or employee accepting any gratuity or compensation for the purpose of influencing his action with respect to the investment of the funds of the system shall thereby forfeit his office, and be subject to other penalties established by law. Accepting meal expenses or other gifts, including those allowed by the current policy, from entities which MOSERS contracts with or could potentially contract with could give the appearance of a conflict of interest. MOSERS officials stated they do not consider the acceptance of the items listed above a conflict of interest because the employees or board members receiving the items would not have otherwise incurred personal out-of-pocket expenses; these expenses would have been paid for by MOSERS. By allowing the acceptance of any items from third parties, it is difficult to determine how MOSERS officials could monitor whether someone's actions had been influenced.

The board should re-evaluate their policy which allows the acceptance of gifts by system officials and employees. If acceptance of gifts is allowed, a system should be established for reporting and monitoring those items received. Records should document the name of the third party, their relationship to MOSERS, expenses paid or gifts received, the name of the recipient, the date, and the estimated value of the item received. These records should be periodically reviewed by the board and staff to ensure such items are reasonable.

WE RECOMMEND the Board of Trustees re-evaluate their policy to determine whether the acceptance of any gifts or other items of value by system officials and employees should be allowed. If allowed, the board should establish a system for reporting gifts which are accepted from third parties and monitor those items for compliance with state law.

AUDITEE'S RESPONSE

The Executive Director provided the following response:

The executive director has established a gift and conflict of interest policy for MOSERS staff which is included in MOSERS personnel policy handbook. The exceptions from the definitions of "gifts" noted by the State Auditor are based on Missouri State law. Specifically, Section 105.485 (8) states as follows:

> *105.485(8) The name and address of each source from which such person received a gift or gifts, or honorarium or honoraria in excess of two hundred dollars in value per source during the year covered by the statement other than gifts from persons within the third degree of consanguinity or affinity of the person filing the financial interest statement. For the purposes of this section, a gift shall not be construed to mean political contributions otherwise required to be reported by law or hospitality such as food, beverages or admissions to social, art, or sporting events or the like, or informational material. For the purposes of this section, a gift shall include gifts to or by creditors of the individual for the purpose of canceling, reducing or otherwise forgiving the indebtedness of the individual to that creditor;……*

If we do decide to re-evaluate the travel policies and the policies relating to the acceptance of gifts, the policy will include a process for tracking any gifts received assuming the items received meet any new or modified definition of a "gift." The employees are required to sign a form indicating that they have received their copy of the personnel policy, which includes the prohibition of receiving ANY gift that was given in an attempt to influence the employee's action or inaction.

As an aside, the personnel policy is currently being revised to incorporate all ethics related requirements and policies into one comprehensive ethics policy. Staff will be given training on the new policy to ensure that they are fully aware of the issues related to ethics and ethical behavior. Again, this would not be seen as a change in what has been common practice.

With regard to the travel expense report documentation, we will revise the travel policy to require staff to document when meals or hotels are included in conference registration fees or paid by outside parties.

FOLLOW-UP ON PRIOR AUDIT FINDING

MISSOURI STATE EMPLOYEES'
RETIREMENT SYSTEM
FOLLOW-UP ON PRIOR AUDIT FINDING

In accordance with *Government Auditing Standards*, this section reports the auditor's follow-up on action taken by the Missouri State Employees' Retirement System on the finding in the Management Advisory Report (MAR) of our prior audit report issued for the three years ended June 30, 2000.

Professional Services Contracts

The Missouri State Employees' Retirement System (MOSERS) Board of Trustees had not formally solicited proposals for the actuarial consulting service or the investment consulting service contracts in recent years.

Recommendation:

The MOSERS Board of Trustees periodically solicit proposals for all professional services.

Status:

Although MOSERS has not implemented procedures to periodically solicit proposals for all professional services, our review of contracts found MOSERS had either periodically solicited proposals for services or periodically reviewed contract rates to ensure fair pricing through either external or internal review. The results of these reviews were generally documented.

HISTORY, ORGANIZATION, AND STATISTICAL INFORMATION

MISSOURI STATE EMPLOYEES' RETIREMENT SYSTEM
HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

The Missouri State Employees' Retirement System (MOSERS) was created September 1, 1957, under an act of the General Assembly to provide retirement benefits to most full-time state employees not covered under other retirement plans of the state, including members of the Water Patrol, members of the General Assembly, elected state officials, administrative law judges and legal advisors, and judges. The system provides retirement, survivor and disability benefits, and life insurance to its members. MOSERS administers, or contracts for the administration of, four retirement plans and an insurance plan: Missouri State Employees' Plan, Administrative Law Judges and Legal Advisors' Plan, Judicial Plan, College and University Retirement Plan, and Missouri State Insurance Plan.

The Missouri State Employees' Plan is a single employer, public employee, defined benefit retirement plan administered in accordance with Chapter 104, RSMo. Within the Missouri State Employees' Plan are two benefit structures known as the MSEP (closed plan) and MSEP 2000 (new plan). As of June 30, 2004, there were 55,914 active, 13,796 terminated vested, and 24,757 retired members and beneficiaries of the Missouri State Employees' Plan.

The Administrative Law Judges and Legal Advisors' Plan (ALJLAP) is a single employer, public employee, defined benefit retirement plan administered in accordance with Chapter 287, RSMo. As of June 30, 2004, there were 57 active, 29 terminated vested, and 25 retired members and beneficiaries of the ALJLAP.

The Judicial Plan is a single-employer, public employee, defined benefit retirement benefit plan administered in accordance with Chapter 476, RSMo. As of June 30, 2004, there were 391 active, 73 terminated vested, and 397 retired members and beneficiaries of the Judicial Plan.

The College and University Retirement Plan (CURP) is a defined contribution plan for education employees at regional colleges and universities in Missouri, and became effective July 1, 2002. The CURP is administered in accordance with Chapter 104, RSMo. MOSERS has been given the responsibility by law to implement and oversee the administration of the plan. MOSERS contracts with an outside service provider, TIAA-CREF, to administer the plan.

The Missouri State Insurance Plan is accounted for as an internal service fund of the State of Missouri and is administered by MOSERS. It provides basic life insurance for eligible members of the MSEP (except employees of the Missouri Department of Conservation, and certain state colleges and universities), members of the Judicial Plan, members of the ALJLAP, and certain members of the Public School Retirement System. The plan also provides duty-related death benefits, optional life insurance for active employees and retirees who are eligible for basic coverage, and a long-term disability plan for certain eligible members.

MOSERS has been a noncontributory plan since September 1, 1972, except for members of the General Assembly and elected state officials who became noncontributory effective September 1, 1976.

The responsibility for the operation and administration of the retirement system is vested in an eleven-member Board of Trustees. This Board consists of two members of the Senate appointed by the President Pro Tem of the Senate, two members of the House of Representatives appointed by the Speaker of the House, two members appointed by the Governor, the State Treasurer, the Commissioner of Administration, and three other members of the retirement system, one of whom must be retired, who are elected by a plurality vote of the membership to four-year terms. The members of the Board of Trustees as of June 30, 2004, were as follows:

Name	Position	Membership	Term Expires
Lori Strong-Goeke	Board Chair	Governor's Appointee	****
Marsha Buckner	Vice Chair	Elected Member	December 2006
Nancy Farmer	Ex-Officio Member	State Treasurer	*
Jacquelyn White	Ex-Officio Member	Commissioner of Administration	*
John Russell	Member	Senator	**
Ed Quick	Member	Senator	**
Bill Deeken	Member	Representative	***
Todd Smith	Member	Representative	***
Carol Gilstrap	Member	Governor's Appointee	****
Don Martin	Member	Elected Member	December 2006
Wayne Bill	Member	Elected Member	December 2006

* Term expires with expiration of office held. Nancy Farmer was replaced by Sarah Steelman as State Treasurer and Jacquelyn White was replaced by Michael Keathley as Commissioner of Administration in January 2005.

** Appointed by the President Pro Tem of the Senate. John Russell and Ed Quick were replaced by Timothy Green and Jason Crowell in January 2005.

*** Appointed by the Speaker of the House.

**** Appointed by the Governor, appointed for the term of the Governor. Carol Gilstrap was replaced by John Pelzer in April 2005 and Lori Strong-Goeke was replaced by John Russell in January 2005. Marsha Buckner was elected Board Chair and Todd Smith was elected Vice Chair in January 2005.

Gary Findlay has served as the Executive Director since his appointment on August 1, 1994. The Executive Director is responsible for employment of the retirement system staff, routine operation of the system, contracting for professional services, and advising the Board on all matters pertaining to the system. The executive staff and their annual compensation as of June 30, 2004, were as follows:

Name	Position		Annual Compensation	
Gary Findlay	Executive Director	$	166,500	(1)
Rick Dahl	Deputy Executive Director – Chief Investment Officer		190,000	(2)
Karen Stohlgren	Deputy Executive Director – Chief Operations Officer		100,066	
Jake McMahon	Chief Counsel		94,336	

(1) In addition to his base salary amount of $166,500, Gary Findlay's employment contract provided for annual incentive compensation up to $20,000 and the purchase of prior retirement service.

(2) In addition to his base salary amount of $190,000, beginning in 2004 Rick Dahl's employment contract provided for annual incentive compensation up to 30 percent of his base compensation, in addition to incentive payments available under the investment section employees' incentive program.

The Board of Trustees has appointed Gabriel, Roeder, Smith & Co., of Southfield, Michigan as actuarial consultants. Summit Strategies, Inc., of St. Louis, Missouri serves as the system’s general asset investment consultant and TimberLink, LLC, of Atlanta, Georgia serves as the system's timberland investment consultant. Mellon Trust, of Boston, Massachusetts serves as the system’s master custodian. Thompson Coburn, of St. Louis, Missouri serves as the system’s external general counsel and Perkins Coie, of Seattle, Washington serves as the system's timberland counsel. Charlesworth & Associates, LLC of Overland Park, Kansas serves as the system’s risk management consultant. Credit Suisse First Boston Corporation, of New York, New York; and Lehman Brothers, of New York, New York serve as securities lending program advisors. The Standard Insurance Company, of Overland Park, Kansas serves as the disability and life insurance administrator. TIAA-CREF, of Chicago, Illinois serves as the CURP administrator. KPMG, LLP, of Kansas City, Missouri serves as the system's independent auditor. Jack Pierce, of Jefferson City, Missouri serves as the system's legislative consultant.

As of June 30, 2004, the following firms managed external investments for MOSERS: AmeriCap Advisors, LLC, of New York, New York; BlackRock Financial Management, of New York, New York; Blackstone Alternative Asset Management, LP, of New York, New York; Blackstone Real Estate Advisors, LP, of New York, New York; Blackstone Bridge Advisors, LP, of New York, New York; Blakeney Management, of London, England; Blum Capital Partners, LP, of San Francisco, California; The Campbell Group, of Portland, Oregon; Capital Guardian Trust Company, of Los Angeles, California; Catterton Partners, of Greenwich, Connecticut; DDJ Capital Management, LLC, of Wellesley, Massachusetts; Dimensional Fund Advisors, Inc., of Santa Monica, California; Grantham, Mayo, Van Otterloo & Co., LLC, of Boston, Massachusetts and Berkeley, California; Hoisington Investment Management Co., of Austin, Texas; Legg Mason Capital Management, Inc., of Baltimore, Maryland; Mastholm Asset Management, LLC, of Bellevue, Washington; Merrill Lynch Asset Management Group, of New York, New York; MHR Fund Management, LLC, of New York, New York; NISA Investment Advisors, LLC, of

St. Louis, Missouri; Oak Associates, Ltd., of Akron, Ohio; OakBrook Investments, of Lisle, Illinois; Oaktree Capital Management, LLC, of Los Angeles, California; Relational Investors, LLC, of San Diego, California; Resource Management Services, LLC, of Birmingham, Alabama; Silchester International Investors, of London, England and New York, New York; Silver Lake Partners, of Menlo Park, California; Trust Company of the West, of Los Angeles, California; and Wayzata Investment Partners, LLC, of Wayzata, Minnesota. A portion of MOSERS investment portfolio is managed in-house by MOSERS staff.

Membership, required contributions, and benefits provided under the MSEP, ALJLAP, and the Judicial Plan are generally as follows:

Missouri State Employees' Plan

The Missouri State Employees' Plan consists of two benefit structures known as the Missouri State Employees' Plan (MSEP) and the Missouri State Employees' Plan 2000 (MSEP 2000). The MSEP 2000 became effective July 1, 2000.

Eligibility

All employees of the state hired for the first time on or after July 1, 2000, whose position normally requires at least one thousand hours of work per year, and who are not simultaneously accumulating creditable service under another retirement program supported by state contributions (other than social security), are eligible and required to participate in the MSEP 2000. Those employees hired prior to July 1, 2000, who meet the requirements above, and do not elect to transfer to the MSEP 2000, participate in the MSEP. MOSERS active members, vested former members, and retirees and survivors under the MSEP may elect to transfer to the MSEP 2000 within established guidelines.

Contributions

The Missouri State Employees' Plan is a non-contributory plan, with the entire cost paid by the State of Missouri. The contribution rate paid by the State for fiscal years 2004, 2003, 2002, and 2001 was 9.35, 8.81, 11.59, and 11.59 percent, respectively, of the Missouri State Employees' Plan membership payroll. Prior to September 1, 1972, contributions by members were required.

Service Retirement Benefits

Service retirement benefits are payable to members who have terminated covered employment and who have met certain eligibility requirements. All service retirement benefits for members in the general employee plan are the greater of an amount based on a formula which multiplies the average monthly pay of the highest thirty-six consecutive months of salary, by the applicable formula factor, by the years of creditable service, and in the case of early retirement, an age reduction factor, or $15 times the full years of creditable service.

Creditable service is a combination of the creditable prior service a member has accrued before becoming a member of MOSERS and the years and full months of service the member has as a member of MOSERS. A regular member is fully vested upon completion of five years of service; a General Assembly member is fully vested upon completion of three full biennial assemblies; and a Statewide Elected Official member is fully vested upon completion of four years of service.

NORMAL RETIREMENT

MSEP

General state employees may retire under the standard (.016) formula factor with full benefits at age sixty-five with five years of service (four years if he/she is retiring directly from active employment), or at age sixty with fifteen years of service. Members may retire at age forty-eight or later with full benefits if their combined age and service equal eighty (Rule of 80).

A uniformed Water Patrol member may retire with full benefits at age fifty-five with five years of service (four years of service if he/she is retiring directly from active employment), or at age forty-eight or later under the Rule of 80. Water Patrol members' base benefit is calculated under the standard (.016) formula factor and this amount is then increased by 33-1/3 percent to determine their normal retirement annuity.

General Assembly members may retire with full benefits at age fifty-five with three full-biennial assemblies and receive $150 times the number of biennial assemblies.

Elected officials may retire with full benefits at age sixty-five with four years of service, at age sixty with fifteen years of service, or at age fifty or later under the Rule of 80. Elected officials with less than twelve years of service as an elected official receive a benefit based on a formula which multiplies the average monthly pay of their highest thirty-six consecutive months of salary, by the standard (.016) formula factor, and by the years of creditable service. Elected officials with twelve or more years of service receive 50 percent of the current statutory salary paid to the elected official in the highest position which the retiree previously held.

MSEP 2000

General state employees and members of the uniformed Water Patrol may retire under the standard (.017) formula factor with full benefits at age sixty-two with five years of service, or at age forty-eight or later under the Rule of 80. General state employees and members of the uniformed Water Patrol who retire under the Rule of 80 are eligible for an additional temporary benefit until they reach the age of sixty-two. The temporary benefit is calculated the same as the normal benefit using an 0.8 percent formula factor.

General Assembly members may retire with full benefits at age fifty-five with three full-biennial assemblies, or at age fifty or later under the Rule of 80 with three full-biennial assemblies. General Assembly members receive one twenty-fourth of the current monthly salary of an active member of the General Assembly multiplied by years of service. The monthly benefit is capped at 100 percent of an active legislator's monthly pay.

Elected officials may retire with full benefits at age fifty-five with four years of service, or at age fifty or later under the Rule of 80. Elected officials receive one twenty-fourth of the current monthly salary of an active elected state official in the highest position held multiplied by years of service. The monthly benefit is capped at twelve years of service or 50 percent of an active elected state official's pay in the highest position held.

EARLY RETIREMENT

MSEP

General state employees and elected officials may retire with reduced benefits at age fifty-five with ten years of service. There are no early retirement provisions for General Assembly members and uniformed members of the Water Patrol.

MSEP 2000

General state employees and uniformed members of the Water Patrol may retire with reduced benefits at age fifty-seven with five years of service. There are no early retirement provisions for General Assembly members and elected officials.

BackDROP

Effective January 1, 2002, MSEP and MSEP 2000 members may elect a "BackDROP" option at retirement that would allow for a lump sum payment in addition to the retirement benefits which are calculated as if the member had retired at a previous date. To be eligible to participate in the BackDROP, a member must be actively employed in a MOSERS covered position on the date first eligible for normal retirement and have been eligible to retire under normal age and/or service conditions for at least two years. A retroactive starting date is selected by the member, which must be on or after the date first eligible for normal retirement benefits and within the five-year period immediately prior to the actual retirement date. This results in a BackDROP period of one to five years depending on the member's situation. The member is paid a lump sum in the amount of 90 percent of the value of the benefit payments that would have been paid during the BackDROP period beginning at retirement or as three equal annual installments beginning at the retirement date.

Members of the General Assembly and elected officials are not eligible for the BackDROP option.

PAYMENT OPTIONS

A retiring member may elect to receive an unreduced benefit with a life income annuity (with no provision for survivorship) or a 50 percent joint-and-survivor option (this option provides for a reduced benefit under the MSEP 2000), or the member may elect to receive a reduced benefit with a 100 percent joint-and-survivor option. The survivor options provide survivor benefit coverage in varying degrees after the retiree's death.

Under any of the joint and survivor options that pay a reduced benefit, if the designated surviving spouse dies before the retiree, the retiree's benefit will "pop-up" or revert to the life income annuity amount effective the first of the month following the spouse's death.

These members may also choose an annuity under the MSEP with either 60 or 120 guaranteed monthly payments (120 or 180 guaranteed monthly payments for MSEP 2000 members). The member receives a reduced monthly benefit for life and if the member dies before receiving the designated number of payments, the beneficiary receives the remaining payments.

Cost-of-Living Adjustments (COLA)

For general employees and uniformed members of the Water Patrol hired prior to August 28, 1997, a COLA to the benefit amount is provided annually based on 80 percent of the previous year's increase in the Consumer Price Index (CPI) with a minimum of 4 percent and a maximum of 5 percent until the total of such COLA increases reaches a cap of 65 percent of the member's base benefit. After reaching this 65 percent cap, those members' annual COLA will be the same as for members who were hired after August 28, 1997, as discussed below.

For general employees and uniformed members of the Water Patrol hired after August 28, 1997, a COLA is based strictly on 80 percent of the increase in the CPI, with no cumulative cap, no annual minimum, and a 5 percent annual maximum.

The above mentioned COLA also apply to members of the General Assembly and elected officials with less than twelve years of service under the MSEP. For elected state officials with 12 or more years of service under the MSEP, all elected officials under the MSEP 2000, and members of the General Assembly under the MSEP 2000, the COLA is equal to the increase in the current pay of an active elected state official in the highest position held, or active member of the General Assembly.

Termination Benefit

If a member under the MSEP ceases to be a state employee, or if the membership is otherwise terminated, after vesting in the system, an accrued pension will commence upon application at the date first eligible for full accrual benefit. Under certain conditions, qualified vested members under the MSEP who terminated employment prior to September 1, 2002, may make a one-time election to receive the present value of their benefit in a lump sum payment. A member terminating state employment on or after August 27, 1997, will not be eligible for the lump sum option if the present value of the benefit exceeds $10,000 on the date of application. To qualify, members must have terminated with less than ten years of service, and not be within five years of eligibility for receiving their benefit.

Death and Survivor Benefits

If a member (with the exception of members of the General Assembly under the MSEP) is fully vested, dies prior to retirement, and the death is nonduty-related, a joint-and-100 percent survivor benefit, based on the member's accrued benefit, will be paid to the eligible surviving spouse. With no surviving spouse, the member's minor children will receive 80 percent of the fully vested member's accrued benefit. For members of the General Assembly under the MSEP, the survivor receives 50 percent of the benefit the member would have received if the member had been normal retirement age on the date of death. Survivors are eligible to receive COLAs.

If the death is duty-related, the eligible surviving spouse or children receive a benefit no less than 50 percent of the member's current pay.

Administrative Law Judges' and Legal Advisors' Plan (ALJLAP)

Eligibility

Individuals appointed or employed as administrative law judges or legal advisors of the Division of Workers' Compensation, members or legal counsel of the Labor and Industrial Relations Commission, the chairperson of the State Board of Mediation, and administrative hearing commissioners are eligible for membership.

Contributions

ALJLAP is a non-contributory plan, with the entire cost paid by the State of Missouri. The contribution rate paid by the State for fiscal years 2004, 2003, 2002, and 2001 was 20.12, 20.02, 22.32, and 22.32 percent, respectively, of the ALJLAP membership payroll.

Service Retirement Benefits

Service retirement benefits are payable to members who have terminated covered employment and who have met certain eligibility requirements. ALJLAP members at least age sixty-two with twelve or more years of creditable service, at least age sixty with fifteen years of creditable service, or at least age fifty-five with twenty or more years of creditable service receive a monthly benefit of one-half of their average monthly salary based on their highest twelve consecutive months of salary. ALJLAP members age sixty-five with less than twelve years of service receive a reduced benefit based upon the years of service relative to twelve years.

Creditable service is a combination of the creditable prior service accrued before becoming a member and the years and full months of service ALJLAP members have as a member of the retirement plan. ALJLAP members are immediately vested.

Cost-of Living Adjustments

For members hired prior to August 28, 1997, a COLA to the benefit amount is provided annually based on 80 percent of the increase in the CPI with a minimum of 4 percent and a maximum of 5 percent until the total of such COLA increases reaches a cap of 65 percent of the member's original benefit. After reaching this 65 percent cap, those members' annual COLA will be the same as for members who were hired after August 28, 1997, as discussed below.

For members hired on or after August 28, 1997, a COLA is based strictly on 80 percent of the increase in the CPI, with no cumulative cap, no annual minimum, and a 5 percent annual maximum.

Termination Benefit

An employee who terminates employment with twelve or more years of creditable service can receive his accrued benefit at age sixty-two. Under certain conditions, qualified vested members under the MSEP who terminated employment prior to September 1, 2002, may make a one-time election to receive the present value of their benefit in a lump sum payment. A member terminating state employment on or after August 27, 1997, will not be eligible for the lump sum option if the present value of the benefit exceeds $10,000 on the date of application. To qualify, members must have terminated with less than ten years of service, and not be within five years of eligibility for receiving their benefit.

Death and Survivor Benefits

The surviving spouse of an ALJLAP member who dies before retirement receives up to 50 percent of the benefit the member would have received based on service to age 70 relative to twelve years. The benefit payable to the surviving spouse of a retired ALJLAP member who dies is 50 percent of the member's accrued benefit. Survivors are eligible to receive COLAs.

Judicial Plan

Eligibility

Individuals appointed or elected as a judge or commissioner of the supreme court or of the court of appeals; a judge of any circuit court, probate court, magistrate court, court of common pleas, or court of criminal corrections; a justice of the peace; or a commissioner or deputy commissioner of the circuit court after February 29, 1972 are eligible for membership.

Contributions

The Judicial Plan is a non-contributory plan, with the entire cost paid by the State of Missouri. The contribution rate paid by the State for fiscal years 2004, 2003, 2002, and 2001 was 51.68, 52.12, 55.30, and 55.30 percent, respectively, of the Judicial Plan membership payroll. Prior to the Judicial Plan becoming funded on an actuarial basis in fiscal year 1999, the plan was funded on a pay-as-you-go basis.

Service Retirement Benefits

Service retirement benefits are payable to members who have terminated covered employment and who have met certain eligibility requirements. Judicial Plan members at least age sixty-two with twelve or more years of creditable service, at least age sixty with fifteen years of creditable service, or at least age fifty-five with twenty or more years of creditable service receive a monthly benefit of one-half of the salary at the time of termination for the highest judicial position ever held. Judicial Plan members at least age sixty-two with less than twelve years of creditable service or at least age sixty with less than fifteen years of creditable service may retire early and receive a reduced benefit based upon the years of service relative to twelve or fifteen years, respectively.

Creditable service is a combination of the creditable prior service accrued before becoming a member and the years and full months of service the Judicial Plan members have as a member of the retirement plan. Judicial Plan members are immediately vested.

Cost-of-Living Adjustments

For members hired prior to August 28, 1997, a COLA to the benefit amount is provided annually based on 80 percent of the previous year's increase in the CPI with a minimum of 4 percent and a maximum of 5 percent until the total of such COLA increases reaches a cap of 65 percent of the member's base benefit. After reaching this 65 percent cap, those members' annual COLA will be the same as for members who were hired after August 28, 1997, as discussed below.

For a member hired after August 28, 1997, a COLA is based strictly on 80 percent of the increase in the CPI, with no cumulative cap, no annual minimum, and a 5 percent annual maximum.

Termination Benefit

An employee who terminates employment with twelve or more years of creditable service can receive his accrued benefit at age sixty-two. Under certain conditions, qualified vested members under the MSEP who terminated employment prior to September 1, 2002, may make a one-time election to receive the present value of their benefit in a lump sum payment. A member terminating state employment on or after August 27, 1997, will not be eligible for the lump sum option if the present value of the benefit exceeds $10,000 on the date of application. To qualify, members must have terminated with less than ten years of service, and not be within five years of eligibility for receiving their benefit.

Death and Survivor Benefits

The surviving spouse of a Judicial Plan member who dies before retirement receives up to 50 percent of the benefit the member would have received based on service to age 70 relative to twelve years. The benefit payable to the surviving spouse of a retired Judicial Plan member who dies is 50 percent of the member's accrued benefit. Survivors are eligible to receive COLAs.

Insurance Plans

Long-Term Disability

Members of MOSERS in a position normally requiring one thousand hours of work a year are covered under the Long-Term Disability Plan, unless they work for a state agency which has its own long-term disability plan. Eligible participants receive 60 percent of their compensation minus primary Social Security, Worker's Compensation, and any employer-provided income. The benefit commences after 90 days of disability or after sick leave expires, whichever occurs last. Long-term disability benefits cease when the disability ends, when retirement benefits begin, when the member returns to work, or upon the member's death. Additional partial disability provisions may also apply.

Uniformed Water Patrol members who are eligible for statutory occupational disability receive benefits equal to 50 percent of compensation at the time of disability. For nonoccupational disabilities, eligible participants receive the same benefit as general employees.

Judges who become disabled receive one-half of their salary on the date of disability. This is a constitutionally-provided disability benefit paid until his/her term expires. Judges are also eligible for the above noted Long-Term Disability Plan.

Basic Life Insurance

All active employees covered under the MOSERS life insurance plan receive Basic Life Insurance in the amount of one-times the employee's annual salary, with a minimum of $15,000, while actively employed. The cost of the Basic Life Insurance is paid by the State. Eligible members, who immediately retire from active employment, are provided $5,000 of Basic Life Insurance by the State at no cost to the member. Terminating employees may convert Basic Life Insurance to an individual policy at their own cost, subject to certain restrictions.

Duty-Related Death Benefit

Active employees covered under the MOSERS' life insurance plan whose death is determined to be duty related receive an amount equal to two-times the employee's annual salary in addition to the basic life insurance amount payable to the beneficiaries of the member.

Optional Life Insurance

Members working for an agency covered under MOSERS' life insurance plan are eligible for Optional Life Insurance. Members are responsible for paying the entire cost of their Optional Life Insurance. Terminating employees may convert Optional Life Insurance and Dependent Insurance to an individual policy at their own cost, subject to certain restrictions.

The maximum amount of Optional Life Insurance coverage available to active employees is six-times the employee's annual salary, up to a maximum of $800,000. The law also enables MOSERS to make dependent spouse and children coverage available to eligible members.

MSEP members who immediately retire from active employment may retain up to the lesser of $60,000 or the amount of Optional Life Insurance coverage held at the time of retirement at the group rate, and may convert any remaining Basic and Optional Life Insurance at individual rates. MSEP 2000 members who retire under the Rule of 80 may retain the amount of coverage prior to retirement at the group rate until age sixty-two, at which time coverage is reduced to $60,000, and may convert any remaining Basic and Optional Life Insurance at individual rates. Dependent coverage for spouse or children ends at the member's retirement and may be converted to individual policies.

MOSERS contracts with an outside service provider, Standard Insurance Company, to administer the long-term disability and life insurance and plans.

Subsequent Events

Senate Bill 202, effective April 26, 2005, merged the Administrative Law Judges' and Legal Advisors' Plan into the Missouri State Employees' Plan. The legislation provides that any administrative law judge or legal advisor who is originally employed as such on or after the effective date will no longer be eligible to participate in the ALJLAP. Instead, such persons will be covered under MSEP. Administrative law judges or legal advisors who were employed or retired before April 26, 2005 will not be affected by this legislation.

During the 2005 legislative session, House Bill 333 and Senate Bill 275 were introduced which proposed the consolidation of the Missouri Department of Transportation and Highway Patrol Employees' Retirement System (MPERS) with MOSERS. Such a consolidation could result in a shift of costs and personnel, depending on how the consolidation was implemented. These bills did not pass during the 2005 legislative session.

At June 30, 2004, MOSERS had 70 full-time employees. An organization chart follows:

MISSOURI STATE EMPLOYEES' RETIREMENT SYSTEM
ORGANIZATION CHART
June 30, 2004