

Comprehensive Annual Financial Report

for the fiscal year ended June 30, 2017

Newcomer Schoolhouse

The Newcomer Schoolhouse is a replica of the 19th century one-room schoolhouse where seven men met in 1914 to form what would become MFA, Inc. The schoolhouse's interior stays true to its historic roots, and is open to visitors. It is located in Shelter Gardens, a five-acre garden at the Shelter Insurance headquarters in Columbia, Missouri, and part of the Columbia Public School District.

M. Steve Yoakum
Executive Director

Prepared by PSRS/PEERS Staff

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Cover photo of Newcomer Schoolhouse
in Columbia, MO, and other
schoolhouses by Renette Reiske.

Newcomer Schoolhouse
Columbia, Missouri
1900s



PUBLIC SCHOOL & EDUCATION EMPLOYEE
RETIREMENT SYSTEMS OF MISSOURI

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Mission Statement

The Public School Retirement System of Missouri and the Public Education Employee Retirement System of Missouri (PSRS and PEERS) work in partnership with the member school districts of this state to provide eligible employees and their beneficiaries with a significant source of income based on the employee's length of service and compensation in order to enhance retirement, disability and death benefits received from other sources.

It is the fiduciary responsibility of those charged with the administration of PSRS and PEERS to:

- Effectively collect contributions,
- Prudently invest the assets to obtain optimum returns,
- Equitably provide benefits,
- Impartially and in accordance with applicable law administer the benefit programs, and
- Set contribution rates that are adequate to fund promised benefits.

The PSRS/PEERS Board of Trustees and staff are committed to providing services to the members and beneficiaries professionally, promptly, courteously and efficiently.

Mission Statement Principles

- We will conduct the business of the Retirement Systems in accordance with the mission statement.
- We will act as fiduciaries in the management of all funds for the exclusive benefit of our members.
- We will adhere to our investment policy to ensure the highest possible investment return consistent with the prudent investment of plan assets.
- We will have as our goal the replacement of 80% of a member's final average salary after a 30-year career through the combination of income from public pensions and, when applicable, the federal Social Security system.
- We will have as our goal the retention of purchasing power of the initial retirement benefit through the retirement years.
- We will maintain an independent retirement system that retains the power of the trustees to set actuarial assumptions, appoint consultants, employ staff, establish a budget and conduct all business of the Retirement Systems.
- We will prepare and distribute an annual financial report that adheres to U.S. generally accepted accounting principles.
- We will provide prompt, courteous and accurate service to our members.
- We will provide clear and complete information to the members and the districts through the use of a summary plan document, newsletters, an annual member account statement and any other documents deemed necessary.
- We will adhere to the highest standards of ethical conduct.

Mt. Sterling Schoolhouse

From 1896 through 1963, Mt. Sterling Schoolhouse served students within a three-mile radius of its location in Gasconade County. Mt. Sterling's highest enrollments occurred in the 1920s and 1930s, with enrollments in the thirties, and was the last one-room schoolhouse in Gasconade County to close. Now completely restored, tours are available upon request. Students in the area today attend Gasconade County R-II School District.



Mt. Sterling Schoolhouse
Mt. Sterling, Missouri
1896 ~ 1963

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Board of Trustees

As of June 30, 2017



Dr. Aaron Zalis
Chair
Elected PSRS
Member



Jason Hoffman
Vice Chair
Elected PEERS
Member



Charles Bryant
Appointed
Member



Yvonne Heath
Elected PSRS
Member



Scott Hunt
Appointed
Member



Jason Steliga
Elected PSRS
Member

NOTE: As of June 30, 2017, one appointed Board position was vacant.

Transmittal Letter



PUBLIC SCHOOL & EDUCATION EMPLOYEE
RETIREMENT SYSTEMS OF MISSOURI

December 1, 2017

To the Board of Trustees and Members of the Retirement Systems:

We are pleased to present the *Comprehensive Annual Financial Report (CAFR)* of the Public School Retirement System of Missouri (PSRS) and the Public Education Employee Retirement System of Missouri (PEERS) for the fiscal year ended June 30, 2017. The PSRS/PEERS' Board of Trustees and staff take great pride in *Serving Missouri's Public Schools Past, Present and Future*. Sound governance decisions of the *past* allowed PSRS and PEERS a unique opportunity in the current year to evaluate enhancing the cost-of-living adjustment (COLA) policy and lowering the assumed rate of return on investments, while maintaining the Systems' financial security and stability for the *present* and *future*. The financial strength and stability of the Systems combined with a strong governance structure allowed such discussions to occur during one of the most challenging times for public pension plans across the nation. These discussions and analyses are covered in additional detail later in this letter.

In addition to providing information to our Board of Trustees and members concerning the financial condition of the Systems, this report also meets our reporting requirements under Sections 169.020.(4).16 and 169.450(4).11 of the Revised Statutes of Missouri (RSMo). Printed copies are available to the public upon request and the complete report is also posted on our website, www.psr-peers.org.

This letter provides a brief overview of the contents of the CAFR. We encourage you to read the Management's Discussion and Analysis on pages 15 to 20 for a more detailed analysis of our financial position for the fiscal year.

Report Contents and Structure

Responsibility for the preparation, accuracy and completeness of this report, including all disclosures, rests with the management staff of PSRS/PEERS (the Systems). The Systems' financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP) within the guidelines established by the Governmental Accounting Standards Board (GASB). To the best of our knowledge, the enclosed data is accurate in all material respects and fairly presents our financial position and operating results.

The management of the Systems is responsible for internal accounting controls, which are designed to provide reasonable but not absolute assurance that the financial statements are free of any material misstatements and assets are safeguarded. The cost of internal controls should not exceed the benefits to be derived. The Systems employ two internal auditors who perform operational reviews to ensure that the internal controls are functioning effectively. We believe the internal controls in place are adequate to meet the purpose for which they were intended.

Our independent external auditors, selected by the Board of Trustees, have conducted an audit of the basic financial statements in accordance with U.S. generally accepted auditing standards. This audit and the financial statements and related footnotes are presented on pages 13 to 52 of this report.

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Toll Free (800) 392-6848 Email psrpeers@psrpeers.org Member Services FAX (573) 634-7934 Employer Services FAX (573) 634-7911

Overview of the Retirement Systems

The Public School Retirement System of Missouri (PSRS), a cost-sharing multiple employer retirement system, was established in 1946 by an act of the Missouri legislature to provide certificated public school employees and their families with a significant and stable source of retirement income, disability and survivor benefits. The majority of PSRS members do not contribute to Social Security.

The Non-Teacher School Employee Retirement System of Missouri (NTRS), also a cost-sharing multiple employer retirement system, was established in 1965 by an act of the Missouri legislature to build a plan similar to PSRS, but for non-certificated public school personnel. The name of the non-teacher system was changed to the Public Education Employee Retirement System of Missouri (PEERS) in August 2005 to more positively represent the members of the System. Members of PEERS contribute to Social Security.

PSRS and PEERS are governed jointly by a seven-member Board of Trustees, composed of three elected PSRS members, one elected PEERS member and three members appointed by the governor.

Unlike most public pension systems, the members of PSRS and PEERS share equally in funding the contributions to the Retirement Systems. The contribution rates in total approximate the contribution rates of similar public plans. However, this funding mechanism has kept the employer contributions lower and the employee contributions higher than many similar public plans.

The combined Systems serve approximately 265,000 total members in 535 districts and other employers. In excess of \$2.7 billion is paid annually to approximately 89,000 service retirees and beneficiary recipients. At June 30, 2017, PSRS/PEERS had a market value of net assets of approximately \$41.7 billion, making it larger than all other public retirement systems in the state of Missouri combined.

Funding Status and Valuation Results

The Board of Trustees evaluates a large amount of information each year including, but not limited to, the annual actuarial valuations prepared by the Systems' external actuaries, PricewaterhouseCoopers, LLC. During the current year, staff and the Board of Trustees reviewed multiple scenarios to enhance the COLA policy as well as lower the assumed rate of return on investments. A lower assumed rate of return decreases the risk profile of the plans, which was an important consideration when reviewing the COLA policy. It's important to note that decreased risk provides for greater stability of future contribution rates and COLAs.

The Board of Trustees amended the Systems' Actuarial Funding Policies at their November 3, 2017 meeting. The Actuarial Funding Policy amendments included a change to the COLA policy and the assumed rate of return on investments. The Board of Trustees adopted a revision to the COLA policy effective with the January 1, 2019 COLA. The only change from the prior policy occurs when the CPI-U is between 0.0% and 2.0%. The prior policy indicated if the CPI-U was between 0.0% and 2.0%, the COLA would be 0.0%. The new policy provides a 2.0% COLA when the CPI-U is between 0.0% and 2.0%, *and* cumulatively reaches 2.0%. During the COLA policy review, the Board of Trustees approved a 1.63% January 1, 2018 COLA. The January 1, 2018 COLA is equal to CPI-U for the fiscal year ended June 30, 2017. The Board of Trustees also reduced the assumed rate of return from 7.75% to 7.6% effective with the June 30, 2017 actuarial valuations. The amendments were based on two critical elements that are at the forefront of all System decisions: the Board of Trustees' fiduciary responsibility and PSRS/PEERS' Continuous Goals.

Fiduciary responsibility includes the duties of loyalty and impartiality. The duty of loyalty requires the operation of the Systems for the exclusive benefit of the members and retirees of those Systems, and must supersede the interests of all other parties. The duty of impartiality requires that the Board not favor any one type of plan participant over another (e.g. active, inactive, retired members). The Board has a fiduciary duty to: 1. Effectively collect contributions, 2. Prudently invest the assets to obtain optimum returns, 3. Equitably provide benefits, 4. Impartially and in accordance with applicable law, administer the benefit program, and 5. Set contribution rates that are adequate to fund promised benefits.

Transmittal Letter, continued

PSRS/PEERS' continuous goals are: 1. Provide for the security and financial stability of the Systems, including maintaining at least an 80% pre-funded ratio, continuing to amortize the unfunded liability until PSRS/PEERS is 100% pre-funded, and allowing for a reasonable assumed rate of return given capital market estimates, 2. Maintain the contribution rates of both Systems at or below current levels, and 3. Provide a consistent COLA for PSRS/PEERS benefit recipients to maintain their purchasing power, noting COLAs should be dependable and affordable without harming the financial stability of the Systems.

The Systems' funding objective continues to achieve a funded ratio of 100% over a closed 30-year period. For this purpose, funded ratio is defined as the actuarial value of assets divided by the actuarial accrued liability determined under the entry age normal cost method and the actuarial assumptions adopted by the Board of Trustees. As of June 30, 2017, PSRS was 84.0% pre-funded, while PEERS was 85.8% pre-funded. Both Systems' showed a slight decrease in funding from the June 30, 2016 funded percentage of 84.8% for PSRS and 86.4% for PEERS. The changes in funded status are primarily due to the investment return assumption being lowered and the future COLA assumption being increased because of changes to the COLA policy. The assumption changes were partially offset by favorable investment experience. Additional information on actuarial assumptions and funding can be found in the actuarial section of this report. Based upon the June 30, 2017 valuations and overall financial projections, the Board of Trustees set the fiscal year 2019 contribution rates at the fiscal year 2018 level for both members and employers.

Investment Activities

The Systems achieved strong absolute and relative returns in fiscal year 2017. The Systems' investment portfolio added approximately \$4.6 billion in investment earnings to the growth of assets during fiscal year 2017. The Systems earned an investment return of 12.5% for fiscal year 2017 (12.3% net of all investment expenses and fees). The total plan return, net of all investment expenses and fees, exceeded both the long-term investment goal (actuarial required rate of return) of 7.75% and the total plan policy benchmark return of 11.0%. PSRS and PEERS are long-term investors with a diversified portfolio that continues to produce strong long-term returns where the annualized investment return is 8.4% (8.3% net of all investment expenses and fees) over the last 30 years.

Additional detailed information regarding the Systems' investments, including policies and strategies, can be found in the Investment Section of this report beginning on page 53.

Legislative Changes During Fiscal Year 2016

Governor Eric Greitens signed legislation (CCS HCS SS Senate Bill 62) impacting the Systems that became effective August 28, 2017. This bill allows retired members of the Systems who have elected a reduced retirement allowance to provide for survivor benefits for his or her spouse to have the retirement allowance increased to the single life annuity amount, with no survivor benefits, if the member and his or her spouse become divorced on or after September 1, 2017 only if the dissolution decree provides for sole retention by the retired person of all rights in the retirement allowance. This bill also changed the deadline for a retired member to nominate a successor beneficiary from 90 days to one year from the date of the remarriage. In addition, the bill expands the statutory provision regarding working after retirement to any individual who is employed by a third party or working as an independent contractor as a substitute teacher or other position normally requiring certification.

Awards

Public Pension Coordinating Council (PPCC), Public Pension Standards Award

PSRS and PEERS each received the Public Pension Standards Awards in 2017 in recognition of meeting professional standards for plan administration and plan funding as set forth in the Public Pension Standards of the PPCC. These awards are presented by the PPCC, a confederation of the National Association of State Retirement Administrators (NASRA), the National Conference on Public Employee Retirement Systems (NCPERS), and the National Council on Teacher Retirement (NCTR).

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to PSRS and PEERS for the *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2016. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports. To be awarded the Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR whose contents meet or exceed program standards. This report must satisfy both U.S. generally accepted accounting principles, applicable legal requirements and GFOA standards. A Certificate of Achievement is valid for only one year. We believe our current report continues to meet the Certificate of Achievement program requirements and are submitting it to GFOA for consideration again this year.

Professional Services

Certain professional services are provided to the Systems by retained consultants. The required opinion letters from two of those consultants, PricewaterhouseCoopers, LLC, actuaries, and Williams Keepers LLC, independent certified public accountants, are contained elsewhere in this report.

Investment consulting services have been provided by Willis Towers Watson.

Acknowledgements

We would like to express our thanks and gratitude to the Board of Trustees, staff, and consultants who have worked diligently to produce this report and to ensure the successful operation of the Systems.

Respectfully submitted,

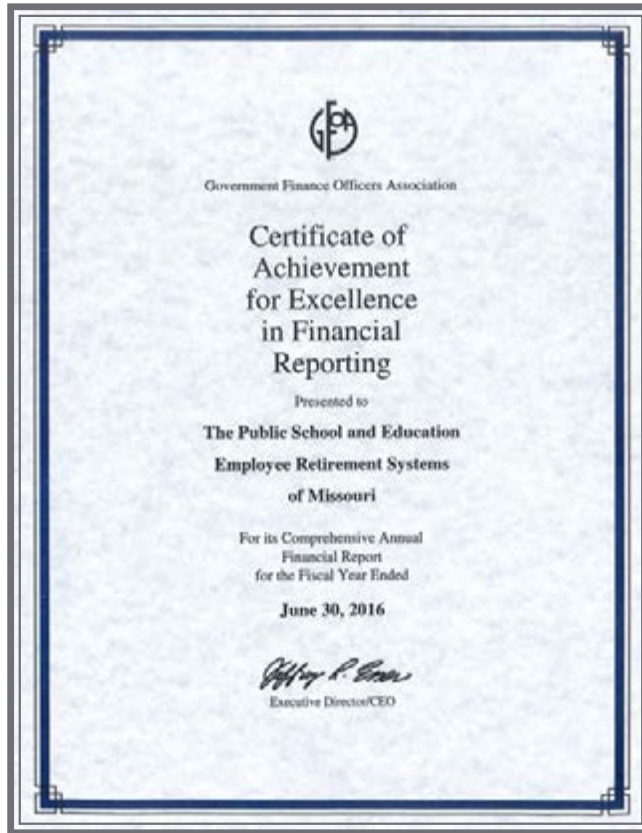


M. Steve Yoakum
Executive Director

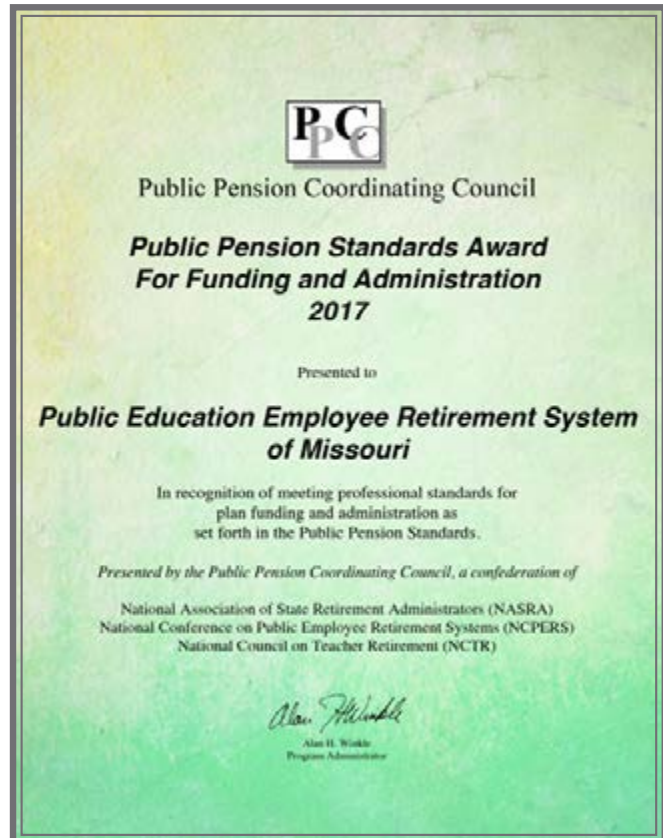


Anita Brand, CPA
Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting



Public Pension Coordinating Council Public Pension Standards Awards



Administrative Organization

As of June 30, 2017



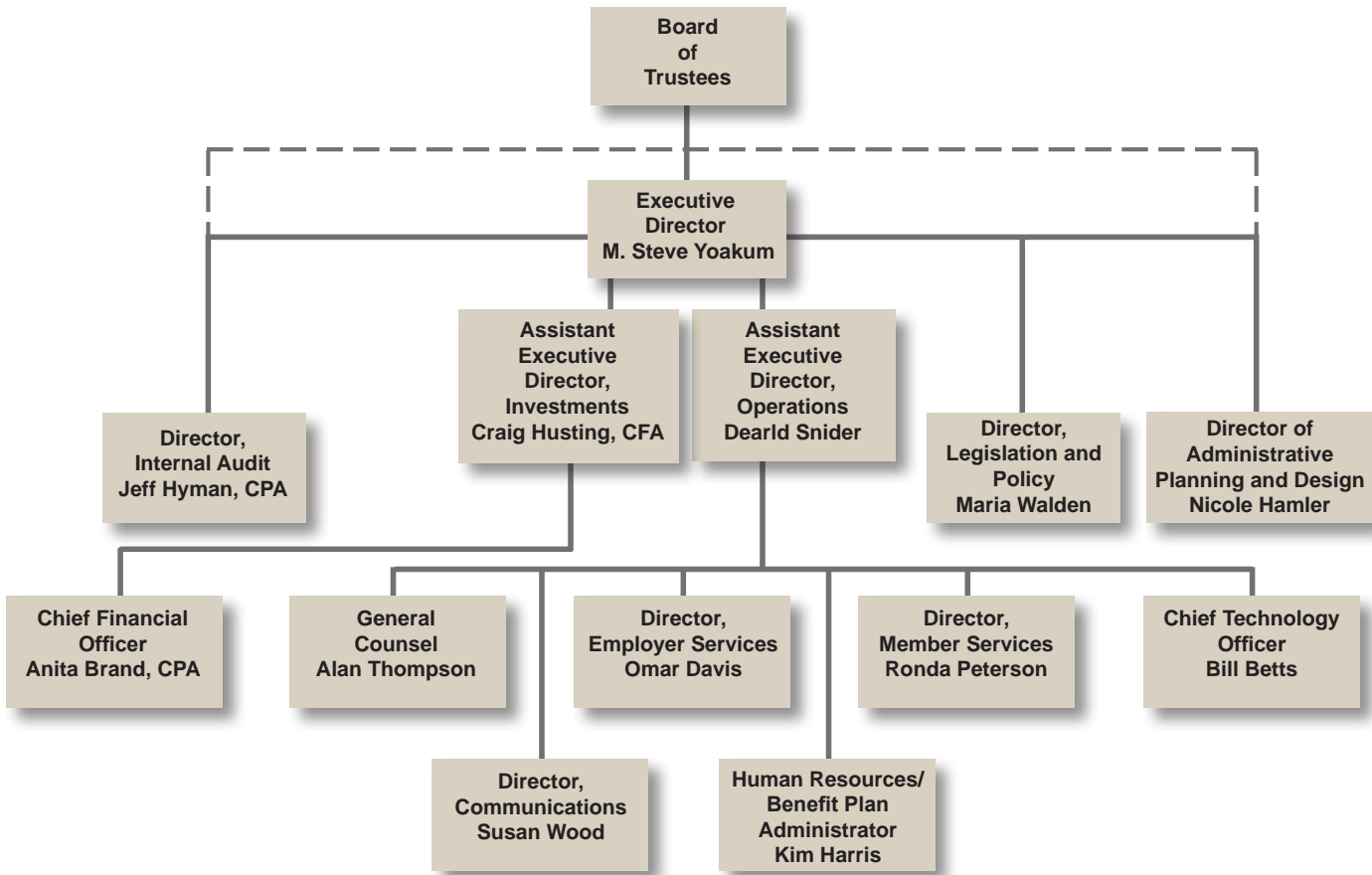
M. Steve Yoakum
Executive Director



Craig Husting, CFA
Assistant Executive
Director, Investments



Dearld Snider
Assistant Executive
Director, Operations



Professional Services

As of June 30, 2017

Actuaries

PricewaterhouseCoopers, LLP

Cindy Fraterrigo, FSA, EA, MAAA
 Brandon Robertson, ASA, EA, MAAA
 Kelly Stolyar, ASA, EA, MAAA
 Chicago, Illinois
 New York, NY

Auditors

Williams Keepers, LLC

Heidi A. Chick, CPA
 Nick Mestres, CPA
 Columbia, Missouri

Technology Consultants

Huber & Associates

James Huber
 Jefferson City, Missouri

Nexum

Mike Scher
 Chicago, Illinois

Sagitec Solutions, LLC

Paul Eberhart
 Roseville, Minnesota

Secure Works, Inc.

Andy Held
 Atlanta, GA

Insurance Consultants

Charlesworth & Associates

Bob Charlesworth
 Overland Park, Kansas

The Insurance Group

Jason Swindle
 Columbia, Missouri

Other Consultants

CBIZ Human Capital Services

Ed Rataj
 Joe Rice
 St. Louis, Missouri

Cortex

Tom Iannucci
 Toronto, Ontario

Legal Counsel

Groom Law Group

David Levine
 Washington, D.C.

Pillsbury, Winthrop, Shaw, Pittman, LLP

Semma Arzapalo
 Los Angeles, California

Thompson Coburn, LLP

Allen Allred
 St. Louis, Missouri

Legislative Consultant

Statehouse Strategies, LLC

James "Jim" Moody
 Jefferson City, Missouri

Medical Advisor

Andrew Matera, M.D.

Columbia, Missouri

Investment Management, Custodial and Consulting fees can be found in the Schedule of Investment Expenses on page 98. Schedules of broker commissions can be found on page 96. Additional information on Investment Managers can also be found in the Investment Section of this report.