HOUSE COMMITTEE ON APPROPRIATIONS

2009-10 Legislative Session

FISCAL NOTE

HOUSE BILL: 2497 **PRINTER'S NO: 4476** **PRIME SPONSOR: D. Evans**

FISCAL IMPACT SUMMARY	**FY 2010/11**	**FY 2011/12**
Expenditure Increase/(Decrease):		
General Fund		
Pension Reform	$0	($115,000,000)
Fiscal Office	$290,169	$4,151,566
Other State Funds (Pension Reform Only)	$0	$0
Local School Entities (Pension Reform Only)	$0	($94,000,000)

OVERVIEW:

The bill amends Title 24 for the Public School Employees' Retirement System (PSERS) and Title 71 for the State Employees' Retirement System (SERS) by making changes to the current actuarial assumptions/methodologies, implementing employer contribution collars, setting a permanent minimum employer contribution rate, changing retirement benefits for new employees, prohibiting pension obligation bonds, and establishing a new Fiscal Office with mandatory and discretionary duties.

PSERS/SERS Actuarial Methodology Changes

While the actuarial cost method applied to both PSERS and SERS will remain as currently set in law at entry-age normal, the following changes are made to other areas of the retirement code:

- Re-amortizes the unfunded accrued liability over 24 years for PSERS and 30 years for SERS.
- Maintains the current 5 -year asset smoothing for SERS; changes the asset smoothing for PSERS from 5 years to 10 years.
- Changes the amortization methodology for PSERS from level dollar in current law to level percent of pay. SERS remains at level dollar.
- Institutes collars (limits) on the contribution rate for both systems. The collar represents the maximum percentage amount that the employer contribution rate could increase in the given fiscal year and is expressed as a percentage of payroll. The collars are listed below and represent the percentage that the employer contribution rate will increase over the prior fiscal year. Percent increases are the same for both PSERS and SERS.
  - FY 2011/12 3%
  - FY 2012/13 3.5%
  - FY 2013/14 and all future years 4.5%

  The collars are set to permanently expire in the first fiscal year in which they are no longer necessary. That will occur during the first fiscal year in which the actuarially calculated contribution rate is less than the collared rate.

- Sets a permanent minimum contribution rate for each system at the employer normal cost rate. This normal cost is the cost of accrued benefits by active members in the given fiscal year expressed as a percentage of the payroll. The 2010/11 projected normal cost for PSERS is 8.08%. The 2010/11 normal cost for SERS will not be available until later in the year; however, the 2009/10 normal cost for SERS is 9.51%.
- Funds any increases in accrued liabilities resulting from enacted legislation, other than this bill, over a 10-year period. For PSERS, this is effective June 30, 2010 using level percentage of pay amortization payments. For SERS, this is effective December 31, 2009 using level dollar amortization payments.

Benefits Changes

The proposed benefit changes affect **new members** of PSERS and SERS with certain exclusions. Benefit changes for new employees do not affect the judiciary. State Police benefits under the DiLauro Award are not affected, and benefits changes to State Police/Park Rangers/Capitol Police occur after the expiration of their respective collective bargaining agreements. The effective date for new PSERS members is July 1, 2011. The effective date for SERS members is December 1, 2010 for legislators, and January 1, 2011 for other members.

For PSERS only, the proposed legislation will:

- Create a new Class T-E with an accrual multiplier rate of 2.0% of final average salary. This is a decrease from the current rate of 2.5% of final average salary. The member contribution rate will remain at 7.5% of pay.
    - New members may opt into a new Class T-F with a 2.5% accrual rate multiplier and required member contribution of 10.3% of pay.
- Increase the retirement age from age 62 with one year of service to age 65 with three years of service.
- Limit the maximum annual retirement benefit at not more than 100% of final average salary (SERS currently has this provision in law).
- Prohibit the purchase of non-qualifying part-time service (NQPTS) after a one-year window. Adds a provision that, once a part-time employee has worked a minimum number of hours required to qualify for pension benefits during one year, the employee does not have to re-qualify for benefits in future years.

For SERS only, the proposed legislation will:

- Create a new Class A-3 with an accrual multiplier rate of 2% of final average salary. This is a decrease from 3% for legislators and 2.5% for other members. The member contribution rate for legislators and other effected members is 6.25% of pay.
    - New members, including legislators, may opt into a new Class A-4 with a 2.5% accrual rate multiplier and required member contribution of 9.3% of pay.
- Increase the retirement age by 5 years. For most SERS members, this change equates to a retirement age of 65, rather than 60. For those members currently eligible to retire at age 50, the new retirement age will be 55.

For both PSERS and SERS, the proposed legislation will:

- Increase the number of years required to vest from 5 to 10 years.
- Eliminate Option 4 (lump sum payout).
- Establish a new shared -risk component:

- A variable contribution rate would be applicable under certain conditions. The basic contribution rate for new employees may increase by up to ½% per year, for a maximum increase of 2%, when the actual investment rate of return is <u>less than</u> the assumed rate of return by 1% or more. When the investment rate of return is <u>higher than</u> the assumed rate of return by 1% or more, the employee contribution rate is decreased by ½%. However, the employee contribution rate never drops below the basic (normal) contribution rate amount. The rate of return comparison is made in three- year increments, until a full 10-year "look back" period is reached. If the retirement system is fully-funded at the time of comparison, the shared risk rate is zero for that period. Additionally, there is no increase in the employee contribution rate when there has not been an equivalent increase in the employer contribution rate over the previous three year period.

- Increase the superannuation requirement for retirement (Rule of 92). Members must reach retirement age (age 65 or 55, with a minimum three years of service as outlined above) *or any combination of age plus years of service that totals 92 with at least 35 years of service.*
- Require members to pay full actuarial cost to purchase nonschool or nonstate service (with the exception of military service due to federal law).
- Prohibit the use of pension obligation bonds for funding liabilities.

<u>Creation of New Legislative Agency</u>

In addition, House Bill 2497 amends Title 71 (State Government), Part V (Boards and Offices) to provide for a new legislative agency entitled the Independent Fiscal Office (IFO).

The legislation outlines mandatory duties of the office:

- Prepare revenue estimates (federal funds, state revenues and other funds), including any projected revenue surplus or deficit for a given fiscal year.
- Provide an assessment of the state's current fiscal condition and a five-year projection of the fiscal condition by November 15 of each year.
- Develop and evaluate performance measures for executive level programs and departments.
- Provide analysis, including economic impact, of all tax and revenue proposals submitted by the Governor or Office of the Budget (OB).
- Study and analyze existing sales and use tax law and propose recommendations to the Governor and General Assembly.
- Establish an internet website.
- Study and analyze the impact of shared- risk contributions under 24 Pa.C.S. § 8321(b) (relating to regular member contributions for current service) and Section 5501.1 (relating to shared -risk member contributions for class A-3 and class A-4 service).

House Bill 2497 also outlines discretionary duties of the office. However, in order to carry out the duties included under the "mandatory" section and those duties relating to revenue estimates, the following also will be necessary:

- Develop and use econometric models to annually forecast state revenues, update the models, and provide information on the models to the General Assembly.

- Provide an analysis of the executive budget.
- Provide an assessment of the Pennsylvania and national economy and the impact of the existing or emerging state or national economic trends on revenue performance for the current year, budget year, and succeeding year.

Subsection 4105 of the act establishes the office's responsibilities regarding revenue estimates.

By May 1, the office shall submit an initial revenue estimate for the next fiscal year to the General Assembly. By June 15 of each year, the office shall submit an official revenue estimate for the next fiscal year. This estimate shall be considered by the Governor and the General Assembly as the amount of revenue which may be considered for the General Appropriation Act for the ensuing fiscal year; unless the General Assembly or the Governor determines that revenues are greater than or less than the estimate provided under the section.

The office may amend the official revenue estimate if changes in law affecting revenues and receipts are enacted or proposed to be enacted with the annual budget or unless significant changes in economic assumptions occur prior to June 30. In this case, the office shall submit the amended estimate to the General Assembly within ten days of the change. The office shall publish the methodology used to develop revenue estimates.

In addition, the office shall provide the General Assembly with all data, assumptions or econometric models used to develop the official estimate. The estimate shall be based on existing law and tax policy and existing or emerging state or national economic trends.

Under House Bill 2497, the Department of Revenue in conjunction with the Secretary of the Budget shall make revenue estimates for the use of the Governor in preparing the budget. The Governor shall certify that any appropriation bill does not cause total appropriations to exceed revenues.

In addition to the official revenue estimate, the office shall prepare a revenue estimate of any change in law affecting revenue and receipts, including regulatory fees, which are proposed or considered as part of the annual state budget. If a proposed change will have a fiscal impact exceeding $10 million in any fiscal year, the estimate shall be prepared on the basis of assumptions that estimate the probable behavioral responses of taxpayers, businesses and other persons and shall include a statement identifying those assumptions.

Subsection 4106 provides that the office shall be notified and attend any briefings under Section 619 of the Administrative Code.

Subsection 4107 provides the office with access to relevant data. Commonwealth agencies shall make monthly electronic expenditure data available to the office, within seven days after the end of each month. The Governor shall direct that monthly revenue reports be submitted to the office. These reports shall be itemized by source and include a comparison with estimated collections for each month. This comparison shall include an analysis of any change in collection patterns which will cause a shortfall or overrun on annual estimates of more than one percent. The act also provides that commonwealth agencies shall prepare other revenue data as may be requested by the office.

Subsection 4108 provides for a revenue conference on January 31 of each year. The meeting shall be with the office, Secretary of the Budget, Secretary of Revenue, and the Chairmen (Majority and Minority) of the Appropriations Committees (House and Senate). The meeting shall discuss the state and national economy; year-to-date revenue collections by tax or revenue source; and any statutory or tax policy changes that may be recommended for the next succeeding fiscal year.

Subsection 4109 provides for access to information. The director is authorized to secure information which he/she deems necessary directly from OB and commonwealth agencies. This includes copies of budget requests submitted by agencies to OB. The office shall have access to any computerized database of a state agency that is required to aid the office in the performance of its duties. In addition, the Secretaries of Revenue and Budget shall post revenue collection data for each deposit day and make that information available to the Office and the General Assembly Appropriations Committees (Majority and Minority).

The office shall be authorized to access any information at the Department of Revenue that is obtained from tax payments, returns or reports, including adjustments or corrections made by the department. This information shall be confidential except for official purposes.

The act also provides for the ability of the Director of the office to bring civil action to require an agency head to provide information.

House Bill 2497 provides for a selection committee and organization committee to organize the office and select its Director. The committee shall be comprised of: the Chairmen and Minority Chairmen of the Appropriations Committees (House and Senate); the Majority and Minority Leaders (House and Senate); President Pro Tempore of the Senate; and Speaker of the House of Representatives. By January 15, 2011, the Committee shall deliberate on procedures to select a director for the office and the operational budget for the office.

The Selection Committee shall appoint the Director by May 30, 2011. The act specifies that the appointment shall be made without regard to political affiliation and solely on the basis of fitness to perform the duties of the office based on the qualifications published by the Selection Committee. The Director shall then appoint a Deputy Director to perform duties as assigned and serve as Director in the case of any absence. The Director's term is six years. Should a person be appointed to fill a remainder of one term, he/she may only serve until the end of that term. The Director may be removed by concurrent resolution. The Director shall appoint and fix the compensation of personnel necessary to carry out the duties and functions of the office. Personnel shall be appointed without regard to political affiliation. In addition, the Director may procure the temporary or intermittent services of attorneys, experts or consultants via contract.

Subsection 4113 specifies that the office shall be considered a legislative agency in terms of "right to know."

House Bill 2497 repeals Section 618 of the Administrative Code to the extent that it is inconsistent with the act.

House Bill 2497 also amends Title 24 to add subsection 8536 to provide for a study. Under the subsection, the office shall study and analyze the implementation of shared risk contributions under Section 8321(B) (relating to regular member contributions for current service) and its impact on the system. The study shall be completed by December 31, 2015. The study shall be submitted to the Appropriations Committees, Finance Committees, and the Governor.

Effective Dates

This act shall take effect as follows:

(1) The provisions of Title 24 (relating to PSERS pension reform) shall take effect July 1, 2011. Benefit reform affects new members employed as of July 1, 2011.

(2) The provisions of Title 71 (relating to SERS pension reform) shall take effect immediately. Benefit reform affects new members employed as of the following dates: members of the legislature December 1, 2010; members affected by Act 111 (State Police, Capitol Police, Park Rangers) upon expiration of the current collective bargaining agreement, all other SERS members January 1, 2011.
(3) Relating to Part V of Title 71 (relating to the fiscal office), the subsection relating to the Selection Committee shall take effect on November 30, 2010. The remainder of the provisions shall take effect on May 1, 2011.
(4) The remainder of this act shall take effect July 1, 2011.

ANALYSIS:

General Fund Impact - Pensions

For PSERS: the general fund cost/savings for pension reform is reflected within the Department of Education's budget in the "school employees' retirement" line item. On average, the general fund pays 55% of the employer contribution cost (the remaining 45% is paid by local school entities).

For SERS: the general fund cost/savings for pension reform is part of the individual agency's personnel budget (GGO). Additionally, there is impact on other funds, such as the Motor License Fund, that contain personnel expenditures. For purposes of this fiscal note, it is assumed that the general fund portion is 50% of the total cost/savings for the SERS portion of this bill.

The following table provides an estimated projection comparing the employer contribution rate and general fund expenditures for both current law and House Bill 2497, along with combined PSERS/SERS savings to the **general fund only** upon enactment of this bill.

($ amounts in millions)

	CURRENT LAW				HOUSE BILL 2497				GENERAL FUND SAVINGS
	Employer Rate		State Share		Employer Rate		State Share		
FY	PSERS	SERS	PSERS	SERS	PSERS	SERS	PSERS	SERS	PSERS + SERS
2010-11	5.64%	5.00%	$419.1	$148.5	5.64%	5.00%	$419.1	$148.5	$0
2011-12	10.22%	8.00%	$782.7	$245.5	8.72%	8.00%	$667.7	$245.5	$115
2012-13	28.71%	26.71%	$2,265.5	$846.0	12.22%	11.50%	$964.2	$364.0	$1,783
2013-14	31.20%	29.27%	$2,539.4	$957.5	16.71%	16.00%	$1,359.6	$523.5	$1,614
2014-15	32.35%	27.77%	$2,718.6	$938.5	21.20%	20.50%	$1,780.4	$693.0	$1,184
2015-16	31.66%	27.51%	$2,750.5	$960.5	24.24%	25.00%	$2,103.2	$873.0	$735
2016-17	31.13%	27.14%	$2,797.9	$978.5	25.13%	28.25%	$2,256.6	$1,018.5	$501
2017-18	30.47%	26.69%	$2,836.9	$994.5	25.92%	27.79%	$2,410.0	$1,035.5	$386

Total Dollar Impact - Pensions

Combined PSERS/SERS long-term fiscal impact (savings) for the pension reform portion of this legislation (through fiscal year 2043-44):

- General Fund: $1.499 billion
- Other State Funds: $738.5 million
- Local School Entities: $621.9 million

General Fund Impact – Fiscal Office

House Bill 2497 requires the Director of the office to be appointed by May 30, 2011. In addition, the act requires an official revenue estimate to be submitted by June 15, 2011. Therefore, in order to perform the prescribed duties, total estimated costs for this new office in FY 2010/11 are $290,169. This assumes payroll and benefit costs ($30,866) for the Director for two pay periods and for four additional staff (Deputy Director, Administrative Assistant, Information Technology Manager, and Forecasting Analyst) for one pay period. In addition, this fiscal analysis assumes a portion of necessary office start-up costs ($241,500) and related operating costs ($17,803) in FY2010/11. Please note that no appropriation for a fiscal office was included in Act 1A of 2010 (General Appropriation Act) to cover costs in FY 2010/11.

In FY 2011/12, this new office will cost approximately $4,151,566. This cost reflects payroll and benefits for 34 employees ($3,379,909); the remainder of office start-up costs ($539,302); and a full year of related operating costs ($232,356). In preparing personnel calculations, this fiscal analysis examined complement in the Department of Revenue and Office of the Budget, currently performing the same functions referenced in House Bill 2497.

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General Note and Disclaimer: *This Fiscal Note was prepared pursuant to House Rule 19(a), and the elements considered and reported above are required by Section 5 of the rule. Estimates are calculated using the best information available. Actual costs and revenue impact incurred may vary from estimates.*