



HOUSE COMMITTEE ON APPROPRIATIONS

FISCAL NOTE

SENATE BILL NO. 1

PRINTERS NO. 1132

PRIME SPONSOR: Corman

COST / (SAVINGS)

FUND	FY 2014/15	FY 2015/16
General Fund	\$0	See fiscal impact
State Employees' Retirement Fund	\$0	See fiscal impact
Public School Employees' Retirement Fund	\$0	See fiscal impact

SUMMARY: Senate Bill 1, printer's number 1132, amends Titles 24 (Education), 51 (Military Affairs) and 71 (State Government) of the Pennsylvania Consolidated Statutes to establish a side-by-side hybrid pension plan for future state and school employees and modify future benefits of current members of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS). The bill also provides for Public Pension and Asset Review Commissions for both PSERS and SERS.

The effective date is immediately upon enactment.

ANALYSIS: The bill establishes a new side-by-side hybrid pension plan for SERS and PSERS, effective for most state employees hired on or after January 1, 2016 and for all school employees hired on or after July 1, 2016. The new pension plan establishes a Defined Contribution (DC) retirement plan and adds a new Cash Balance (CB) retirement benefit tier to the existing Defined Benefit (DB) plan structure.

DC Plan -

- Minimum employee contribution rate of 3% for both SERS and PSERS.
- An additional 3% of voluntary employee contributions are permitted; although these contributions will not be considered pickup contributions so there is no tax deferral on these contributions.
- Employer contribution of 2.59% for PSERS and 4% for SERS (with 5.5% for psychiatric security aides). No employer contribution for additional voluntary contributions.
- Vesting provisions - employee contributions and earnings thereon vest immediately. Employer contributions and earnings incrementally vest over 4 years.
- At retirement or separation, employees may elect a full or partial lump sum payment or a single life annuity based on the actuarial value of employee account.
- Individuals electing a distribution of vested employer defined contributions must purchase an annuity.
- At least 10 investment options, through at least 3 providers, are to be available to participants.

- The provisions of Act 44 of 2010, known as Protecting Pennsylvania's Investments Act, will apply to investments under the DC plan.
- Loans from the plan to active employees are not permitted, unless required by law
- For fiscal years ending on or before June 30, 2016, for SERS and June 30, 2017, for PSERS expenses of the DC Plan, as approved by the General Assembly through an appropriation, shall be paid from the General Fund. For fiscal years beginning after June 30, 2016, for SERS, and on or after July 1, 2017, for PSERS expenses of the DC Plan, as approved by the General Assembly, shall be paid from interest on participants' investments or assessments on the balances of the participants' individual investment accounts.

CB Plan -

- Mandatory participation in CB plan for new employees (except SERS groups noted below).
- Employee contribution rate of 3% for SERS and PSERS.
- No employer contribution.
- Optional participation for pre-Act 120 members (contribution up to 3%). Post-Act 120 employees may also participate contributing income earned over the Social Security limit (currently \$118,500 and adjusted for inflation annually).
- Members earn interest at the rate paid on 30-year treasury bonds, but no more than 4%.
- Beginning in 2019, excess interest may be earned if actual investment returns exceed SERS/PSERS investment return assumptions. One-half of the net returns on the cash balance accounts in excess of the investment return assumptions will be allocated to CB members.
- Vesting - Employee contributions and earnings thereon vest immediately.
- Lump sum and annuity options will be available. The annuity will be actuarially equivalent to the balance of the member's cash balance account. Rollovers into another qualified plan are also permitted.

Exempt Groups - the following SERS groups of public safety and enforcement officers are exempt from participating in the new hybrid plan and maintain current pre- and post-Act 120 plan design but are subject to the plan changes being made to current plan members:

- Pennsylvania State Police Officers (DiLauro award still applies for members accruing 20 or more years of service as a State Police Officer)
- Enforcement Officers
- Corrections Officers
- Wildlife Conservation Officers
- Other Commissioned Game Commission law enforcement personnel
- Delaware River Port Authority Police officers
- Park Rangers
- Capitol Police Officers
- Campus Police Officers employed at State-owned Educational Institutions and Community Colleges
- Campus Police Officers at the Pennsylvania State University
- Police Officers employed at Ft Indiantown Gap and other designated military installations & facilities

Members of the General Assembly - upon re-election or election to a term of office that begins after December 31, 2015, all current members of the General Assembly will cease to accrue benefits in the SERS DB plan and will instead become mandatory participants in the side-by-side hybrid plan for all future service. Eligibility points in the current DB plan will carry forward for purposes of vesting in the new DC plan.

Current Member Changes - The bill also imposes changes on future service of pre-Act 120 and post-Act 120 members of SERS and PSERS, including public safety and enforcement officer groups previously outlined and members of the General Assembly. The changes in benefits would occur on service accrued after December 31, 2015.

Actuarially Neutral Option 4 Retirement - For pre-Act 120 members who choose Option 4 retirement after December 31, 2015, the annuity calculation for all service attained after January 1, 2016 will be actuarially neutral meaning that the annuity will be discounted by the assumed rate of return versus the current 4%.

Final Average Salary/Anti-spiking - for SERS members only, beginning January 1, 2016, a member's final average salary will be calculated using the higher of the highest five years of salary including overtime or the highest three years of salary excluding overtime. Service that occurred before December 31, 2015 would be calculated using the three highest years of salary.

Shared Risk/Shared Gain Provisions -

PSERS members - For Pre-Act 120 members a shared risk/shared gain calculation will be made every 3 years comparing the actual and assumed rates of return for the prior 10 years. For every percentage point in system earnings in excess of or below the assumed rate of return, the employee contribution rate will be reduced or increased by 0.5%. The shared risk/shared gain rate cannot be 2 percentage points more or less than the base employee contribution rate.

SERS members - For Pre-Act 120 members (Class AA), a contribution savings provision has been provided. A calculation will be made every 3 years comparing the actual and assumed rate of return for the past ten years. For every percentage point in earnings realized in excess of the assumed rate of return, the employee contribution rate will be reduced by 0.5%. The employee contribution rate may not decrease by more than 5 percentage points.

SERS and PSERS Post-Act 120 members - Shared gain provisions will apply to post-Act 120 members of SERS and PSERS, who are already subject to shared risk provisions. The shared risk/shared gain rate cannot be 2 percentage points more or less than the applicable base employee contribution rate.

Other Provisions

Public Pension and Asset Investment Review Commissions are established for both SERS and PSERS to make recommendations regarding active and passive investment performance and strategies. Each Commission will include 3 members appointed by the following:

the President Pro Tem of the Senate, the Speaker of the House and the Governor. The Commissions are to submit their findings and recommendations to the General Assembly and Governor within six months of their first organizational meetings. The Joint State Government Commission shall provide logistical and other support. Temporary staff may also be employed as needed. The Commissions shall expire within 60 days of submitting the required report. At that time any unspent appropriation shall lapse back to the General Fund.

Mandatory Training - Board members of both SERS and PSERS will be required to obtain eight hours of mandatory training in investment strategies, actuarial cost analysis and retirement portfolio management on an annual basis.

Legal counsel to the SERS and PSERS boards shall serve independently of the Governor’s Office of Chief Counsel, the General Assembly and the Attorney General.

SERS Specific - Member statements for the period ending December 31, 2015 shall not be required to reflect provisions of the Act.

PSERS Specific - The bill adds provisions to address delinquent school entity payments to PSERS. A subsection is added to the School Employees’ Retirement Code to provide that a school entity is still expected to make full payment to the PSERS fund in the event the receipt of the Commonwealth’s portion of the employer liability is delayed because of delinquent salary reporting or other conduct by the school entity. Language is also added to provide that employers whose payments to the PSERS Fund are delinquent shall be charged interest at the annual interest rate adopted by the board based on the assumed rate of return in effect in the fiscal year in which the payments are required to be paid.

FISCAL IMPACT: Based on an actuarial note prepared by the Public Employee Retirement Commission, the enactment of this legislation is projected to result in the savings shown below for the pension funds over PERC’s 32-year projection period. The present value of the expected cash flow savings as of June 30, 2015 (based on current assumed rate of return of 7.5%) are also shown.:

	(Dollars in Thousands)		
	<u>SERS</u>	<u>PSERS</u>	<u>Total</u>
Total Projected Cash Flow Savings	(\$1,771,700)	(\$8,351,700)	(\$10,123,400)
Present Value of Cash Flow Savings	(\$606,900)	(\$2,501,400)	(\$3,108,300)

PSERS actuary did provide work to PERC to differentiate the projected savings from the implementation of the side-by-side hybrid (cash flow savings of \$3,536.1 million) and the prospective design changes for current plan members (cash flow savings of \$4,815.6 million).

There will be costs incurred by SERS and PSERS for the implementation of the new pension plans and to accommodate changes to the existing DB pension plan. Significant costs will be incurred to develop IT systems necessary for the new pension plan design. Both systems will need to secure additional legal counsel and consulting services to make system changes on a very short timeline. SERS estimates start-up costs to be \$11,539,000 and annualized costs to be \$3,594,000. PSERS estimates start-up costs to be \$7,095,000. Second year costs for PSERS are estimated to be \$5,262,000.

Costs will also be incurred for the Public Pension and Asset Investment Review Commission both SERS and PSERS are to establish for investment strategy review. It has been projected that both SERS and PSERS will incur a cost of approximately \$150,000 to complete the required studies with the Commissions.

Senate Bill 1 provides that costs are to be paid from the General Fund through June 30, 2016 for SERS and June 30, 2017 for PSERS. After that time fees can be assessed on DC plan participants for the cost of running the DC plan.

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House Appropriations Committee (R)

DATE: June 30, 2015

Estimates are calculated using the best information available. Actual costs and revenue impact incurred may vary from estimates.