HOUSE COMMITTEE ON APPROPRIATIONS

FISCAL NOTE

SENATE BILL NO. 1071 **PRINTERS NO**. 1913 **PRIME SPONSOR**: Browne

COST / (SAVINGS)

FUND	**FY 2015/16**	**FY 2016/17**
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 1071, printer's number 1913, amends Titles 24 (Education), 51 (Military Affairs) and 71 (State Government) of the Pennsylvania Consolidated Statutes to create new membership classes for future members of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS), to establish defined contribution pension plans for new members of PSERS and SERS, and to revise certain funding provisions of the pension systems.

The effective date is immediately upon enactment.

ANALYSIS: The bill establishes a new stacked hybrid pension plan for SERS and PSERS, effective for all state employees except Pennsylvania State Police troopers hired on or after January 1, 2018, and for all school employees hired on or after July 1, 2018. In addition to adding a new Defined Benefit (DB) tier to the existing DB plan structure, the new hybrid pension plan would provide a mandatory Defined Contribution (DC) retirement plan for all new employees..

The specific components of the stacked hybrid are outlined below.
<u>New Defined Benefit Tier</u> –

- Employee contributes 6% of salary up to maximum salary of $50,000 or 25 years of service.
- The $50,000 salary limit would be indexed by 3% per year for inflation.
- Benefit accrual rate is 2% and member would be vested after 10 years of service.
- Annual retirement benefit would be 2% of highest five-year average salary multiplied times the number of years of service, but limited to 25 years.
- Plan members would reach superannuation at age 65, with three years of credited service, or when total attained age and years of service equal 92 with credited service being at least 35 years. If the member is under age 65, annuity would be reduced based on actuarial factors.
- Members with five years of service would be eligible for disability benefits.
- Survivors of members with 10 years of service would be eligible to receive death benefits.
- Option 4 (withdraw of member's contributions plus interest at retirement in exchange for lower annuity) would not be permitted.

- For new State Police officers hired on or after January 1, 2018, voluntary overtime will be limited to no more than 10% of base pay. Any voluntary overtime above this limit will be excluded from retirement covered compensation.
- Shared risk contributions would be imposed on members if investment returns do not meet the assumed rates of return. The Shared Risk Contribution would mirror the Act 120 of 2010 Shared Risk structure so that a plan member's (employee's) contribution to the defined benefit component of the hybrid plan would be not less than 6% and not more than 8%.

Defined Contribution Component –

- Employee contributes 1.5% of salary on first $50,000 of salary and employer provides match of 0.5%.
- Employee contributes 7.5% of salary above $50,000 and employer provides match of 4.0%.
- When employee reaches 25 years of service, regardless of salary, employee contributes 7.5% of salary to defined contribution plan since defined benefit component of member plan is suspended.
- Vesting is immediate for employee contributions and at three years for employer contributions.
- Each defined contribution participant will have an individual investment account where all employee and employer contributions will accumulate and investment earnings/losses, fees and costs will be credited or charged.
- Additional voluntary member contributions are allowed from eligible roll-overs or direct trustee-to-trustee transfers.
- The trust fund for participants' individual defined contribution investment accounts will be separate from the PSERS and SERS defined benefit trust funds.
- Defined contribution disability and death benefits would be based on participants' vested account balances.
- Language is included to specify that PSERS and the SERS boards would not be liable for any plan participants' investment losses.
- PSERS and SERS boards must provide not less than ten (10) options which are offered by three or more providers of investment options when establishing standards and criteria for investment options for eligible Defined Contribution (DC) plan participants.
- School districts that establish or maintain a 403(b) plan or a 457 plan must select a minimum of four financial institutions or pension management organizations, in addition to the financial institution or pension management organizations that entered into an agreement with the PSERS board.
- All expenses, fees and costs of administering the plan and the trust and investing assets of the trust shall be borne by the participants and paid from assessments against the balances of the individual participant's investment accounts. There is an exception for fiscal years ending on or before June 30, 2020 when the expenses, fees and costs of establishing and administering the DC Plan and trust shall be paid by the Commonwealth through an annual appropriation from the General Fund.

<u>Funding Provisions</u> –

- Employer contribution rate collars will remain at the current 4.5% rate as established under Act 120 of 2010. The employer contribution rate collar limits the annual increase in the employer contribution rate to no more than 4.5% from the prior year.
- PSERS and SERS employer contribution rates related to existing unfunded accrued liabilities would be based upon the entire payroll - both defined benefit and defined contribution.
- Language is included in the bill to provide that savings realized as a result of the enactment of the new hybrid pension plan are to be used to pay down unfunded accrued liabilities. The consulting actuaries for PSERS and SERS were not able to value cost savings resulting from more rapid pay down of the Systems' unfunded liabilities.

<u>Other Provisions</u>

"Footprint Rule" – Pre-2018 PSERS and SERS members who have a break in service and return to employment after the inception of the new hybrid pension plan would return to their prior class of service unless the member exercised a one-time election to waive their prior class of service and join the hybrid pension plan prospectively. Such election must be made within 45 days of returning to service.

PSERS Premium Assistance – New school employees hired after July 1, 2018 will continue to be eligible for premium assistance payments (a $100 per month payment to eligible annuitants who participate in approved health care plans to help pay health insurance premiums).

Language is added to the School Employees' Retirement Code and the State Employees' Retirement Code to provide that legal counsel to the PSERS and SERS boards shall serve independently of the Governor's Office of Chief Counsel, the General Assembly and the Attorney General.

FISCAL IMPACT: Based on a letter issued by the Public Employee Retirement Commission (PERC) on June 13, 2016, 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 (based on current assumed rate of return of 7.5%) is also shown:

	(Dollars in Thousands)		
	SERS	**PSERS**	**Total**
Total Projected Cash Flow Savings	($4,047,500)	($1,003,400)	($5,050,900)
Present Value of Cash Flow Savings	($850,000)	($180,300)	($1,030,300)

There will be costs incurred by PSERS and SERS for the implementation of the new pension plans and to accommodate changes to the existing DB pension plan. 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 relatively short timeline. Costs to establish the new hybrid plans shall be paid by the Commonwealth through annual appropriations for fiscal years ending on or before June 30, 2020. PSERS estimates start-up costs to be $9,000,000 in 2016-17. Second year costs for PSERS are estimated to be $7,000,000, followed by $5,000,000 in the next two fiscal years. Beginning in 2020-21 PSERS plan participants will cover all expenses, fees and costs of administering the DC plan and trust through assessments against the balances of individual participants' investment accounts. SERS estimates start-up costs to be $18,040,000 over the four-year period from 2016-17 through 2019-20. Like PSERS plan participants, SERS plan participants will cover all expenses, fees and costs of administering the DC plan and trust through assessments against the balances of individual participants' investment accounts beginning in 2020-21.

Costs will also be incurred by school employers to implement the reporting mechanisms needed for the new hybrid pension plan. The Pennsylvania Association of School Business Officials provided an estimate of $2,000 per school entity for software, training and administrative costs related to the implementation of the new plan. Assuming there are approximately 770 school entities (including charter schools) implementation costs are estimated to be $1,540,000. Costs could vary depending on the complexity of the necessary software and reporting systems the school entities have to put in place to provide salary and defined contribution participant data to PSERS in a timely manner.

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House Appropriations Committee (R)

DATE: June 14, 2016

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