SENATE APPROPRIATIONS COMMITTEE FISCAL NOTE

BILL NO. House Bill 2497

PRINTER'S NO. 4476

AMOUNT

Pension Reform -- Aggregate Savings through FY 2043-2044
Independent Fiscal Office -- $2,043 Million in new expense in FY 2011-12

FUND

Pension Reform
General Fund $1.499 Billion in savings
Other Funds $738.5 Million in savings

Independent Fiscal Office
General Fund $2.043 Million new costs

DATE INTRODUCED

May 11, 2010

PRIME SPONSOR

Representative D. Evans

HISTORY OF BILL

Referred to APPROPRIATIONS, May 11, 2010
Reported as amended, June 7, 2010
First consideration, June 7, 2010
Laid on the table, June 7, 2010
Removed from table, June 14, 2010
Second consideration, with amendments, June 15, 2010
(Remarks see House Journal Page 844-849), June 15, 2010
Third consideration, with amendments, June 16, 2010
Final passage, June 16, 2010 (192-6)

In the Senate

Referred to FINANCE, June 17, 2010
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Re-committed to FINANCE, Sept. 29, 2010
Re-reported as amended, Oct. 12, 2010
Second consideration, Oct. 12, 2010
Re-referred to APPROPRIATIONS, Oct. 12, 2010
Re-reported as amended, Oct. 13, 2010

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DESCRIPTION AND PURPOSE OF BILL

House Bill 2497 amends Title 24 (Education) relating to the Public School Employees' Retirement Code and Title 71 (State Government) relating to the State Employees' Retirement Code. The amendments made by the legislation modify the actuarial funding requirements of both the Public School Employees' Retirement System (PSERS) and the State Employees Retirement System (SERS) and establish a new shared risk benefit plan and new benefit classes for most new members of PSERS and SERS.

The bill also establishes a non-partisan Independent Fiscal Office (IFO) as an independent agency.

Pension Reform

Actuarial Funding Methodology Changes

The bill makes the following changes to the actuarial funding methodologies used by PSERS and SERS:

- Re-amortizes all PSERS actuarial accrued liabilities over a 24 year period and SERS actuarial accrued liabilities over a 30 year period.
- Changes the asset smoothing period in which investment gains and losses are recognized for PSERS from 5 to 10 years. SERS asset smoothing period remains at 5 years.
- Provides for the increases in PSERS and SERS accrued liabilities resulting from the enactment of new legislation, other than this bill, to be funded over a 10 year period.
- Institutes level percentage of pay methodology to pay PSERS debt. Currently, PSERS utilizes the level dollar methodology.
- Imposes collars on the rate which employer contributions may increase annually for PSERS and SERS. The collars are set as follows: for FY 2011-12, 3%; FY 2012-13, 3.5%; and, FY 2013-14 and each year thereafter, 4.5%. When the actuarially required contribution rate is less than the collared rate, the rate is to be set at the actuarially required contribution rate and the collars will no longer apply.
- Prohibits the use of pension obligation bonds to fund liabilities.

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Shared Risk Defined Benefit Plan

- Establishes a new "shared risk" defined benefit plan for all new members, except the judiciary. Every three years, this plan compares PSERS and SERS actual investment rate of return to the actuarial assumed rate of return for the previous ten years. If the actual rate of return is less than the actuarial assumed rate by 1%, the employee contribution rate is increased by 0.5%. Conversely, if the actuarial assumed rate is greater than the actual rate by 1%, the employee contribution rate is decreased by 0.5%. The employee contribution rate never drops below the regular contribution rate and the employee rate may not increase by more than 2%.

New Member Benefit Changes

- Benefit changes, including the "shared risk" defined benefit plan, only affect new PSERS and SERS members and do not affect the judiciary.
- Establishes a new membership class (T-E) for all new members of PSERS. Employees in this class would have an annual benefit accrual rate of 2%, as compared to 2.5% for most current employees and an employee contribution requirement of 7.5% of compensation, the same amount as most current employees pay.
- Establishes an optional new class (T-F) of PSERS membership that provides an annual benefit accrual rate of 2.5%, but requires an employee contribution requirement of 10.3% of compensation. An employee would be required to select this option within 45 days of becoming a member of PSERS.
- Establishes a new membership class (A-3) for all new members of SERS, including members of the General Assembly. Employees in this class would have an annual benefit accrual rate of 2%, as compared to 2.5% for most current employees and an employee contribution requirement of 6.25% of compensation, the same amount as most current employees pay.
- Establishes an optional new class (A-4) of SERS membership that provides an annual benefit accrual rate of 2.5%, but requires an employee contribution requirement of 9.3% of compensation. An employee would be required to select this option within 45 days of becoming a member of SERS.
- Increases the vesting period for new PSERS and SERS members from 5 to 10 years.

- Increases the superannuation eligibility requirements for new members to a “rule of 92” with 35 years of credited service. The “rule of 92” is calculated by adding the members age and number of years of service.
- Superannuation eligibility for classes of employees who presently superannuate at 50 years of age will increase to 55 years of age.
- Eliminates the Option 4 “lump sum” withdrawal for new PSERS and SERS members.
- Requires creditable nonstate service to be purchased at the full actuarial cost, except for intervening military service.
- Limits the ability of new members to purchase non-qualifying part-time service.
- Limits a new member’s annual retirement benefit to not more than the member’s final average salary.
- The new retirement benefits become effective for PSERS members on June 30, 2011, for SERS members January 1, 2011 and for legislators December 1, 2010.
- State Police benefits under the “DiLauro Award” are not affected.
- Benefit changes for the State Police, Park Rangers and Capitol Police will occur after the expiration of their collective bargaining agreements.

Independent Fiscal Office

Duties
The IFO will have the following duties:

- Prepare revenue estimates for Federal funds, State revenues, and any other funds. The estimate must include any projected surplus or deficit for a given fiscal year.
- Provide an assessment of the Commonwealth’s current and projected fiscal condition by November 15 of each year and a projection of what the fiscal condition will be during the next five years.
- Develop performance measures for the various Executive departments and programs. The IFO will also evaluate the performance measures promulgated and results reported by Executive departments.
- Analyze all tax and revenue proposals, including their economic impact, submitted by the Governor or the Office of the Budget.

- Study and analyze the existing sales and use tax law and propose recommendations to the Governor and the General Assembly for amending the tax to accomplish the following:
    - Eliminate obsolete and unnecessary provisions
    - Expand the tax base as necessary
    - Ensure a competitive economic market in this Commonwealth
    - Protect the stability of the Commonwealth's budget
    - Establish an Internet website.
    - Study and analyze the implementation of the Shared Risk Contribution provisions of the State and Public School Employee Retirement Codes.

Discretionary Duties
The IFO may conduct the following:

- Develop econometric models to annually forecast State revenues and to make those models and databases available to the Appropriations Chairmen and the Majority and Minority Leaders of the House and Senate.
- Analyze the Executive Budget, including budgetary projections, economic outlook and impact; and an analysis of tax and revenue proposals. This analysis may include performance recommendations for the various programs.
- Provide an assessment of the Pennsylvania economy and the national economy and the impact of the state or national economic trends on revenue performance.

Revenue Estimates
The initial revenue estimate is due by May 1 for the next fiscal year. The official and final estimate for the next fiscal year is due by June 15.

The estimate shall be considered by the Governor and the Legislature as the amount of revenue that 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 by the IFO. The Office may amend the revenue estimate if there are changes in law affecting revenues and receipts or if significant changes in economic assumptions occur prior to June 30.

The IFO must publish the methodology used to develop the estimates. The assumptions and econometric models used to develop projections and revenue estimates would be provided to the House and Senate Appropriations Committees and the Secretary of the Budget.

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 the official revenue estimate.

Revenue Estimates – Required Information

- Projected revenue collections by specific tax or revenue source, including Federal funds, the General Fund, the Lottery Fund and the Motor License Fund.
- All data, assumptions and econometric models used to develop a revenue estimate.
- Any projected surplus or deficit for the current fiscal year.
- The estimate would be based on existing law and tax policy, and State and national economic trends.
- The IFO would prepare an estimate of any change in State tax law proposed as part of the annual budget. If the change is in excess of $10,000,000 in the fiscal year, the estimate must include probable behavioral responses of persons to the change in the law.

Budget Information

The Independent Fiscal Office must be notified and attend any briefings provided by the Governor or the Secretary of the Budget under section 619 of the Administrative Code.

Expenditures

Commonwealth agencies must make monthly expenditure data available to the IFO within seven days of the end of the month. The data must be provided by fund, appropriation, department, and by organization within each department.

Revenue Reports

The Governor shall direct that monthly revenue reports be submitted to the IFO. The reports must show the actual collection of revenue itemized by source and a comparison of the actual collections with estimated collections. The comparison is to include an analysis of any change in collection patterns which will cause a shortfall or surplus of more than 1%.

Commonwealth agencies will prepare any other revenue data as may be requested by the IFO.

Except for information that is confidential pursuant to statute, the IFO will have access to all information on "inquiry-only" screens through an integrated central computer system.

Revenue Conference

By January 31 of each year, the IFO will convene a meeting with the Secretary of the Budget and the Majority and Minority Chairmen of the Appropriations Committees. At the meeting they will discuss the following:

- An assessment of the Pennsylvania and national economy.
- Current year-to-date revenue collections.
- Any statutory or tax policy changes that may be recommended by the Governor or the General Assembly for the following fiscal year.

Access to Information

The director of the IFO is authorized to obtain information, data, expense information, estimates and statistics directly from a Commonwealth agency or a political subdivision. The agency or political subdivision is required to furnish any information the director determines to be necessary in the performance of the duties of the office. By agreement with an agency head, the director may utilize the services, facilities and personnel of the agency with or without reimbursement.

Office of the Budget

The director of the IFO is authorized to obtain all necessary information from the Office of the Budget and Commonwealth agencies. The Office of the Budget must submit to the office copies of final agency budget requests at the same time they are submitted to the General Assembly.

Computer Database
The IFO will have access to any computer database of a State agency required to aid the office in the performance of its duties.

Daily Revenue Data
The Secretary of Revenue and the Budget Secretary shall post and provide access to revenue collection data to the IFO and the Majority and Minority Chairmen of the Appropriations Committees.

The Governor, the Attorney General, the Auditor General and the State Treasurer shall cause to be prepared any other revenue data as may be required by the IFO.

Tax Information
The IFO shall be authorized to access any information in the possession of the Department of Revenue that is obtained from tax payments, returns of reports, including adjustments or corrections made by the Department. The information accessed shall be confidential.

Civil Action
If requested information is not provided to the IFO within a reasonable time, the director may bring a civil action to require the agency head to provide the information.

Director
A Selection and Organization Committee is established to select the director of the IFO. The members of the committee will be the Chairmen and Minority Chairmen of the Appropriations Committees, the Majority and Minority Leaders, the President pro tempore, and the Speaker.

The Selection and Organization Committee shall appoint a director by May 30, 2011, whose term of office shall be six years. The director may be removed by a concurrent resolution passed by the Senate and House.
The director will appoint and fix the compensation of personnel to carry out the duties and functions of the office. The director may procure temporary or intermittent services of experts or consultants by contract.

House Bill 2066 repeals section 618 of the Administrative Code to the extent that it is inconsistent with this act.

The act shall take effect as follows:

- The effective date section is immediate.
- Section 10 regarding the Selection and Organization Committee shall take effect November 30, 2010.
- The remainder of the act shall take effect May 1, 2011.

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FISCAL IMPACT:

Long Term Fiscal Impact of Pension Changes

According to the Public Employee Retirement Commission (PERC) the combined effect of the changes made by House Bill 2497 to PSERS and SERS will result in $2.859 billion in employer costs savings through FY 2043-2044. Specifically, $1.382 billion in savings to PSERS and $1.477 billion in savings to SERS.

Assuming that 55% of PSERS and 50% of SERS employer costs accrue to the General Fund, savings to the General Fund are estimated to amount to $1.499 billion. Assuming that 50% of the SERS employer costs accrue to other state funds, such as the Motor License Fund, savings to the other funds are estimated to amount to $738.5 million. School districts will realize the remainder of the PSERS savings which are estimated to amount to $621.9 million.

Additionally, PERC provided information in its actuarial note showing the cost containment and benefit reduction changes made by the Senate Finance Committee in the current version of the bill save $32.979 billion in employer costs when compared to version passed by the House of Representative in June.

Short Term Fiscal Impact of Pension Changes

The changes made by House Bill 2497 which re-amortize PSERS and SERS actuarial accrued liabilities, increase the asset smoothing for PSERS and impose collars on employer contribution rates will defer current liabilities, result in reduced employer contribution rates in the short-term and avoid the projected employer contribution rate spike.

	Current law Employer Rate			House Bill 2497 Employer Rate			
Fiscal Year	PSERS	SERS	Current Costs	PSERS	SERS	New Costs	Cost Savings
2010-11	5.64%	5.00%	$ 1,059	5.64%	5.00%	$ 1,059	$ -
2011-12	10.22%	8.00%	$ 1,914	8.72%	8.00%	$ 1,705	$ (209)
2012-13	28.71%	26.71%	$ 5,811	12.22%	11.50%	$ 2,481	$ (3,330)
2013-14	31.20%	29.27%	$ 6,532	16.71%	16.00%	$ 3,519	$ (3,013)
2014-15	32.35%	27.77%	$ 6,820	21.20%	20.50%	$ 4,623	$ (2,197)
2015-16	31.66%	27.51%	$ 6,922	24.24%	25.00%	$ 5,570	$ (1,352)
2016-17	31.13%	27.14%	$ 7,044	25.13%	28.25%	$ 6,140	$ (904)
2017-18	30.47%	26.69%	$ 7,147	25.92%	27.79%	$ 6,453	$ (694)
2018-19	29.71%	26.21%	$ 7,233	26.83%	27.15%	$ 6,793	$ (440)

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Miscellaneous Provisions Fiscal Impact of Pension Changes

The benefit changes made to new member benefits that provide for the "shared risk" defined benefit plan, decrease the annual benefit accrual rate from 2.5% to 2%, and increase vesting from 5 years to 10 years will have the effect of increasing the employees' share of pension costs and reducing the cost to employers in the future as new members enter PSERS and SERS.

The optional 2.5% benefit accrual rate for new members should not increase employer costs because the increased employee contribution requirement for PSERS of 10.3% and for SERS of 9.3% are projected to cover the costs related to the enhanced benefit.

The benefit changes made to new member benefits which eliminate the Option 4 "lump sum" withdrawal, change superannuation eligibility to a "rule of 92" with 35 years of service, require creditable nonstate service to be purchased at its full actuarial value and eliminate the purchase of non-qualifying part-time service will result in actuarial gains for both PSERS and SERS.

Independent Fiscal Office

The Independent Fiscal Office is estimated to cost $24,000 in fiscal year 2010-11. Because the director must not be appointed until May 30, 2011, the cost analysis assumes that the IFO will not be fully functional until FY 2011-12. The $24,000 first-year cost represents one month's salary and benefits for the director and one-half month's salary and benefits for the deputy director.

For fiscal year 2011-12, the IFO will cost approximately $2.04 million and $1.7 million annually thereafter. The costs are based on an estimated 14 employees. The costs breakout as follows:

Description	**Cost**
Start-up Costs	
Furniture	$109,188
Office Equipment	$9,988
Communications Equipment	$12,920
Electronics/Computer	$173,059
Office Fit-Out Costs	$25,000
Total Projected Start-up	**$330,155**
Recurring Costs	
Payroll & Benefits	$1,510,679
Operating	$202,335
Total Recurring	**$1,713,014**
TOTAL	**$2,043,169**

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These estimates assume that, in its first year of operation, the office will focus primarily on the prescribed mandated duties related to revenue forecasting and analysis. In subsequent years, the office may choose to devote additional resources to the enumerated discretionary duties, thus potentially requiring additional personnel and additional fiscal resources.