SENATE APPROPRIATIONS COMMITTEE FISCAL NOTE

BILL NO. Senate Bill 1082

PRINTER NO. 1460

AMOUNT

See Fiscal Impact

FUND

School Employees' Retirement Fund
State Employees' Retirement Fund

DATE INTRODUCED

December 4, 2015

PRIME SPONSOR

Senator Browne

DESCRIPTION AND PURPOSE OF BILL

Senate Bill 1082 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 changes are as follows:

New Side-by-Side Hybrid Pension Plan

- Establishes new side-by-side hybrid defined benefit /defined contribution plans for new PSERS employees effective July 1, 2017 and for new SERS employees January 1, 2018.
- The defined benefit component includes:
  - An employee contribution of 4% for PSERS employees and 3% for SERS employees.
  - A benefit accrual rate of 1% of final average salary per year of service.
  - Final average salary calculated based on the last 5 years of service.
  - "Shared-risk/shared-gain" provisions to be calculated every 3 years comparing the actual rate of return and the assumed rate of return for the previous 10 years. For every 1% in earnings realized in excess of or below the assumed rate of return, the employee contribution will be reduced or increased by 0.5%. Provides that the employee contribution cannot increase or decrease by more the 2%.
  - PSERS employer benefits vest after 5 years, SERS after 10 years.
  - Cost-neutral Option 4 lump sum withdrawals.
  - PSERS members would be eligible for healthcare premium assistance.
- The defined contribution component includes:
  - An employee contribution of 3.5% for PSERS employees and 3.25% for SERS employees.
  - An employer contribution rate of 2.5%.
  - Provides for optional employee contributions up to the IRS limits.
  - Mandatory contributions would be pretax pickup contributions, but voluntary contributions would not.

  - Employee contributions vest immediately and employer contributions vest after 3 years.
  - Provides for each employee to have an individual investment account.

Hazardous Duty Employees

- Exempts hazardous duty employees (Pennsylvania State Police, Enforcement Officers, Corrections Officers, Wildlife Conservation Officers, Port Authority Police Officers, Park Rangers, Capitol Police Officers, Campus Police Officers and Police Officers at military instillations) from the provisions of the new side-by-side hybrid plan. These employees would continue to be members of the current SERS defined benefit plan, but would be subject to changes made in the legislation for current SERS employees outlined below.

Pre-Act 120 Member Benefit Changes

- Provides for "shared-risk" and "shared-gain" provisions for both PSERS and SERS members to be calculated every 3 years comparing the actual and assumed rate of return for the previous 10 years. For every percentage point in earnings realized in excess of or below the assumed rate of return, the employee contribution requirement will be reduced or increased by 0.5%. Provides that the employee contribution requirement cannot increase or decrease from the regular employee contribution requirement my more than 2%.

Post-Act 120 Member Benefit Changes

- Provides for a "shared-gain" provision for both PSERS and SERS members for which "shared-risk" provisions currently apply. Provides that the employee contribution requirement cannot be reduced below the regular employee contribution requirement by more than 2%.

Elected Officials

- Provides all current elected officials are enrolled in the new side-by-side hybrid upon reelection unless electing to stay in their current benefit class.

Revised Final Average Salary Calculation For Legacy DB

- Provides for final average salary to be calculated for SERS members using the higher of the current 3-year average salary formula excluding overtime or a 5-year average salary formula including overtime beginning January 1, 2017.
- This provision does not apply to State Police who qualify for the "DiLauro Award."

Actuarially Neutral Option 4 Withdrawals For Legacy DB

- Provides for an actuarially neutral option 4 lump sum withdrawal on contributions made beginning on July 1, 2016 for PSERS members and beginning on July 1, 2016 for SERS members.
- Contributions and statutory interest made prior to the respective dates are not subject to this provision.

Collars

- Provides for collars to reduce the employer contribution rates of both PSERS and SERS in fiscal year 2016-2017 of 2.25% and in fiscal year 2017-2018 of 4.5%.

Other Provisions

- Establishes the Public Pension and Asset Investment Review Commission to study and make recommendations to the General Assembly and the Governor regarding investment performance, investment fee transparency, stress testing of investment performance fluctuation and investment strategies.
- Adds the Secretary of Banking and Securities to both the PSERS and SERS boards.
- Requires PSERS and SERS Board members to obtain 8 hours of relevant training annually.
- Prohibits the PSERS or SERS board chair from being a member of the board that represents active system members or annuitants or is a current member of the General Assembly.
- Provides for PSERS and SERS legal counsel to serve independently from the Governor's Chief Counsel, the General Assembly and the Attorney General.
- Provides funding mandate protection to each PSERS and SERS member so that after the employer compensation schedule meets the full actuarial amount, members will have a contractual right to enforce that the annual employer required contribution be made on a timely basis and ensure that previously accrued retirement benefits will be paid upon retirement.

FISCAL IMPACT:

Based on the provisions contained in the legislation, Buck Consultants, PSERS consulting actuary, estimates that the impact of the amendments contained in Senate Bill 1082 will result in a cumulative savings of $484 million. The Hay Group, SERS consulting actuary, estimates that the impact of the amendments made by the legislation will result in a cumulative savings of $2.1 billion.

It should be noted that the savings determined by the consulting actuaries for PSERS and SERS assume the plans meet their assumed rates of return.

Transitioning a part of the Commonwealth's pension portfolio to a defined contribution plan through the side-by-side hybrid plans will mitigate significant future risk and result in savings.

An analysis of the current PSERS plan provided by the system shows that an investment return of 6.5%, 1% less than the assumed annual rate of return, will result in $30.8 billion in additional employer costs. Through the transition to the side-by-side hybrid as provided in the legislation, this risk is mitigated by 50%, or by $15.4 billion, due to the reduction in the benefit accrual rate and by splitting the employer contribution rates between the defined benefit and defined contribution plans.

A similar analysis provided by SERS of its current plan shows that an investment return of 6.4%, 1.1% less than the assumed rate of return, will result in $22 billion in additional employer costs. Through the transition to the side-by-side hybrid as provided in the legislation, this risk is mitigated by 50%, or $11 billion, due to the reduction in the benefit accrual rate and by splitting the employer contribution rates between the defined benefit and defined contribution plans.

Implementing the "shared-risk" provisions for pre-act 120 employees will also mitigate future risk and result in savings to the Commonwealth.

An analysis of the current PSERS plan provided by the system shows that with an investment return of 6.5%, the "shared-risk" provisions would result in a savings of $1.23 billion. This savings is in addition to $6.35 billion in savings provided by the "shared-risk" provisions contained in Act 120.

A similar analysis provided by SERS of its current plan shows that with an investment return of 6.4%, the "shared-risk" provisions would result in a savings of $435 million. This savings is in addition to $1.17 billion in savings provided by the "shared-risk" provisions contained in Act 120.

The provisions related to the Public Pension and Asset Investment Review Commission will result in a reduction in investment expenses paid by both PSERS and SERS. Presently, PSERS and SERS spend approximately $610 million on investment expenses on an annual basis. Assuming annual growth in current investment expenses of 3% over the next 30 years, a 15% reduction in annual investment expenses will result in a savings of $4.5 billion, $3.2 billion for PSERS and $1.3 billion for SERS.

Language is included in the legislation providing for the Commonwealth to make annual appropriations to PSERS and SERS for transition costs related to the implementation of the new pension plans and changes to the existing plans.