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COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES
APPROPRIATIONS COMMITTEE

MAIN CAPITOL
ROOM 140
HARRISBURG, PENNSYLVANIA

BUDGET HEARING
SERS and PSERS

TUESDAY, MARCH 5, 2019
1:59 P.M.

BEFORE:

HONORABLE STANLEY SAYLOR, MAJORITY CHAIRMAN
HONORABLE MATT BRADFORD, MINORITY CHAIRMAN
HONORABLE ROSEMARY BROWN
HONORABLE LYNDA SCHLEGEL-CULVER
HONORABLE SHERYL DELOZIER
HONORABLE GEORGE DUNBAR
HONORABLE JONATHAN FRITZ
HONORABLE MATT GABLER
HONORABLE KEITH GREINER
HONORABLE SETH GROVE
HONORABLE MARCIA HAHN
HONORABLE DOYLE HEFFLEY
HONORABLE LEE JAMES
HONORABLE FRED KELLER
HONORABLE JOHN LAWRENCE
HONORABLE JASON ORTITAY
HONORABLE CLINT OWLETT
HONORABLE CHRIS QUINN
HONORABLE GREG ROTHMAN
HONORABLE JAMES STRUZZI
HONORABLE JESSE TOPPER
HONORABLE RYAN WARNER
HONORABLE MARTINA WHITE

1 BEFORE (continued):

2 HONORABLE DONNA BULLOCK
3 HONORABLE MORGAN CEPHAS
4 HONORABLE CAROLYN COMITTA
5 HONORABLE AUSTIN DAVIS
6 HONORABLE MARIA DONATUCCI
7 HONORABLE ELIZABETH FIEDLER
8 HONORABLE MARTY FLYNN
9 HONORABLE EDWARD GAINEY
10 HONORABLE PATTY KIM
11 HONORABLE STEPHEN KINSEY
12 HONORABLE LEANNE KRUEGER
13 HONORABLE STEPHEN MCCARTER
14 HONORABLE BENJAMIN SANCHEZ
15 HONORABLE PETER SCHWEYER

9

NON-COMMITTEE MEMBERS:

10 HONORABLE KERRY BENNINGHOFF
11 HONORABLE MARTY CAUSER
12 HONORABLE RUSS DIAMOND
13 HONORABLE GARTH EVERETT
14 HONORABLE MARK GILLEN
15 HONORABLE BARB GLEIM
16 HONORABLE JOHN HERSHEY
17 HONORABLE MARK KELLER
18 HONORABLE BRETT MILLER
19 HONORABLE FRANK RYAN
20 HONORABLE DAVE ZIMMERMAN
21 HONORABLE KEVIN BOYLE
22 HONORABLE MAUREEN MADDEN
23 HONORABLE ED NEILSON
24 HONORABLE EDDIE DAY PASHINSKI

18

COMMITTEE STAFF PRESENT:

19 DAVID DONLEY, MAJORITY EXECUTIVE DIRECTOR
20 RITCHIE LaFAVER, MAJORITY DEPUTY EXECUTIVE
21 DIRECTOR
22 MIRIAM FOX, DEMOCRATIC EXECUTIVE DIRECTOR
23 TARA TREES, DEMOCRATIC CHIEF COUNSEL

22

23

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P R O C E E D I N G S

1
2 MAJORITY CHAIRMAN SAYLOR: Call the
3 Appropriations Committee to order.

4 And I will ask the members who are
5 about to testify if they would please rise and
6 raise your right hand.

7 GLEN GRELL,

8 JAMES GROSSMAN,

9 TERRILL SANCHEZ,

10 BRYAN LEWIS,

11 called as a witnesses, having been duly sworn
12 or affirmed, testified on their oaths as
13 follows, to wit:

14 MAJORITY CHAIRMAN SAYLOR: We will
15 start off with Representative James.

16 REPRESENTATIVE JAMES: Thank you,
17 Mr. Chairman.

18 Good afternoon, ladies and gentlemen.
19 Thank you for coming.

20 We'll have an opportunity today to
21 hear from a lot of different people about
22 rates of return and things of that nature, but
23 I wanted to move forward a little bit and
24 something a tad more esoteric and talk about
25 asset allocation.

1 So, first question is, how often do
2 your boards meet to review and discuss asset
3 allocation? Could you walk us through that
4 process?

5 SERS CIO LEWIS: Sure. This is --
6 I'll start. Bryan Lewis, chief investment
7 office for the State Employees Retirement
8 System.

9 So, the SERS asset allocation is
10 reviewed every two years by our board. That
11 process that takes place involves a
12 combination of staff working with external
13 consultants, as well as with our actuaries, to
14 understand where we currently are, from an
15 asset perspective, but we also take into
16 account the liabilities and obligations that
17 we're required to meet.

18 REPRESENTATIVE JAMES: How have the
19 targets, the asset allocation targets, changed
20 over the last, say, three to five years.

21 SERS CIO LEWIS: So, again, for us at
22 SERS, the asset allocation targets have
23 remained fairly similar over the last five
24 years and well beyond that, actually over the
25 last ten years. The changes that have taken

1 place in our asset allocation have really been
2 around the categorization or grouping of the
3 types of investments. But our focus on return
4 generation and growth assets has remained
5 consistent over the actually last ten years
6 and beyond.

7 REPRESENTATIVE JAMES: Same two
8 questions for PSERS, please.

9 PSERS CIO GROSSMAN: Sure.

10 Our board will look at the asset
11 allocation once a year, so, formally, in an
12 August meeting, normally. We'll go through
13 sort of the same process that SERS does. We
14 do an asset liability study. That's normally
15 done once every three years unless something
16 really changed. We'll go through the expected
17 capital market assumptions, what we expect
18 from the various asset classes, which we can
19 choose from to invest in, and the board will
20 set an asset allocation based on what it
21 believes to be a return that we can get that
22 equals 7 and a quarter or more, with the least
23 amount of risk we can do, so to do that.

24 And over the past three to five
25 years, the allocation hasn't materially moved

1 over the past three to five years. It's a
2 rather balanced allocation. So, we try to
3 balance our risk between equities, between
4 fixed income, between real assets.

5 You know, if you look at the past ten
6 years, there was a significant shift about ten
7 years ago where we really reduced the equity
8 risk of the portfolio and looked to generate a
9 more balanced portfolio, a more balanced
10 return stream over time that we thought would
11 best suit the system.

12 REPRESENTATIVE JAMES: When you
13 encounter a December such as the December of
14 2018, do your boards react to that and make
15 any changes? Or do you stick to it?

16 PSERS CIO GROSSMAN: No. We would
17 stick to it. I mean, the asset allocation is
18 built for the long run. It's not built for
19 quarter to quarter. And there's a fear that
20 you overreact to a situation. We try not to.
21 We want to build a portfolio that's durable
22 over a long period of time.

23 REPRESENTATIVE JAMES: Yep. And I
24 agree with that. Thank you very much.

25 Can we talk just for a minute about

1 what I'll call alternative investments or the
2 nontraditional, not stocks, not bonds?

3 PSERS CIO GROSSMAN: Sure.

4 REPRESENTATIVE JAMES: What portion
5 of your portfolios are made up by those? What
6 are their characteristics?

7 PSERS CIO GROSSMAN: Well, we have 15
8 percent private equity that we consider an
9 alternative. We have 10 percent in absolute
10 return, which really represents more of the
11 hedge fund book for us; about 10 percent in
12 private real estate, that could be considered
13 alternative; and about 10 percent private
14 credit. So, those would be the ones where I
15 would consider alternatives on our books.

16 REPRESENTATIVE JAMES: So, you
17 purchase positions in bank loans? Is that --

18 PSERS CIO GROSSMAN: Part of it, part
19 of private credit would include bank loans,
20 would be part of that allocation. So there's
21 lots of other things, other corporate-type
22 debt, that we would have in there as well.

23 REPRESENTATIVE JAMES: Okay. Do
24 you -- I mean, I know what my opinion is. Do
25 you think heading in that direction carries

1 more risk?

2 PSERS CIO GROSSMAN: Actually, no. I
3 believe -- the direction we've gone actually
4 carries a little bit less risk than you would
5 see in a normal public, say, high-yield bond.
6 I mean, most -- a lot of the high-yield bonds
7 today in the public spectrum don't have
8 covenants tied to them. So, you're
9 essentially lending money to a company without
10 covenants on if they miss a payment or things
11 like that. Whereas, in the private credit
12 field, we're underwriting those loans -- or
13 our partners are underwriting those loans, and
14 actually having specific covenants in that if
15 they don't meet their obligations there's
16 specific remedies that we can take, including
17 cramming down the equity and taking the
18 company if we need to.

19 REPRESENTATIVE JAMES: Same question
20 for SERS, please.

21 SERS CIO LEWIS: Sure. We have
22 approximately 31 percent of our asset
23 allocation in alternative or private assets.
24 We are currently below our asset allocation
25 target within those areas.

1 And to address the question on risk,
2 we believe, as well as --

3 MAJORITY CHAIRMAN SAYLOR: Mr. Lewis,
4 if I could ask you to draw the mic a little
5 closer to you.

6 SERS CIO LEWIS: Sure. Absolutely.

7 Again, so we have about 31 percent of
8 our assets in, what I'll call broadly,
9 alternatives, but what will make up what most
10 people consider private investments.

11 We agree with PSERS that that has
12 helped to reduce the risk in the portfolio,
13 particularly in volatile markets. We saw the
14 stronger performer in our portfolio in 2018,
15 with the downturn in December, within our
16 private equity portfolio. Over the last
17 twenty-five years, it has returned 13.9
18 percent to our portfolio versus a U.S. stock
19 index of approximately 9.8 percent over the
20 same time period with less volatility in
21 pricing.

22 So, with that, we use alternatives to
23 help balance out some of the ebbs and flows in
24 the normal public market cycle.

25 REPRESENTATIVE JAMES: I'd like to

1 keep going, but thank you very much,

2 Mr. Chairman.

3 MAJORITY CHAIRMAN SAYLOR: Thank you.

4 I did want to mention, we were joined
5 by two members who are not members of the
6 Appropriations Committee, Representative Ryan
7 is here observing, as well as Representative
8 Miller. They're here to observe the going on.

9 Next we will move to Representative
10 Sanchez.

11 REPRESENTATIVE SANCHEZ: Thank you,
12 Mr. Chairman.

13 Thank you to the executive directors
14 and the chief investment officers for being
15 here today.

16 I wanted to explore a little bit the
17 assumed rate of return of 7.25 percent. It
18 looks like that, you know, that has worked
19 over the past twenty years, but want to invite
20 both systems to explore that topic with an eye
21 towards is that going to get us there when
22 there's market downturns? Which, if there's
23 one thing predictable, there's a market
24 downturn every so often, sometimes
25 catastrophic.

1 And beyond that, if that is a
2 reasonable assumption, market notwithstanding,
3 with the unfunded liability and whether
4 there's an ability to make up for those head
5 winds by adjusting that rate.

6 So, if both systems could take a
7 moment, or if it's the same explanation.

8 PSERS CIO GROSSMAN: Sure.

9 I mean, as I indicated earlier to the
10 earlier question when asked about allocation,
11 we do at look at that every year to see if the
12 expected returns from what we expect in the
13 public markets and the private markets would
14 be -- allow us to get to our 7 and a quarter
15 percent return assumption.

16 And last time we looked at it, in
17 fact we just looked at it through the end of
18 December, we believe our asset allocation is
19 really structured to get about 7.8 percent
20 over the long run, based on the assumptions
21 that our consultant uses, which is Aon. But
22 it's something we look at every year.

23 And if you go back twenty years ago,
24 you didn't have to take as much risk twenty
25 years ago to get your return assumptions. So,

1 you are taking a little bit more risk today to
2 do that. Right? If you think back in that
3 late '70s, early '80s, you get 20 percent in a
4 CD. Today, you're going to get something less
5 than that. You're going to get in the 2
6 percent, 3 percent range for cash today.

7 So, you do need to take risk to get
8 to the return, but we do believe that it's
9 reasonable. And we look at it on, you know,
10 on a five-year basis, from an actuarial
11 standpoint. We just looked at it a year or
12 two ago. And we'll look at it again in three
13 or four years.

14 But the board will look at the risk
15 we're taking to try to achieve that return.
16 And if we believe we can get that return with
17 a reasonable amount of risk, we will continue
18 at that rate.

19 Now, from a historical standpoint,
20 the rate used to be 8 and a half percent a
21 number of years ago. So, the board has
22 dropped it all the way down to 7 and a
23 quarter, recognizing that the return
24 environment's probably more difficult on a
25 forward-looking basis.

1 REPRESENTATIVE SANCHEZ: And does
2 that take into account the head winds of
3 unfunded liability and reductions in employee
4 and -- employee contributions when moving
5 towards the defined contribution plans?

6 PSERS CIO GROSSMAN: Right, it does
7 take into account all of that.

8 REPRESENTATIVE JAMES: So, that would
9 be all-encompassing, your analysis about
10 target rate of return.

11 PSERS CIO GROSSMAN: Yes.

12 PSERS EXECUTIVE DIRECTOR GRELL: If I
13 could just add to that, for the PSERS
14 standpoint, the last time the rate was
15 adjusted, it was adjusted in June of 2016,
16 which brought it down to the 7 and a quarter
17 rate.

18 We do look at it at least -- we
19 looked at it more intensely every three years,
20 but look at it as part of that August asset
21 allocation meeting that Jim talked about
22 earlier.

23 And as comparison, at least as of the
24 -- as of December of last year, there were
25 forty public funds that had assumed rates of

1 return lower than ours and sixty-five that had
2 assumed rates of return higher than ours. So,
3 we think we're -- we're certainly not an
4 outlier. We're right on the more conservative
5 side of the pack.

6 SERS EXECUTIVE DIRECTOR SANCHEZ:
7 Terry* Sanchez, with the State Employees
8 Retirement System. Good afternoon.

9 REPRESENTATIVE SANCHEZ: Good
10 afternoon. No relation.

11 SERS EXECUTIVE DIRECTOR SANCHEZ:
12 Darn.

13 Our return -- our assumed rate of
14 return is 7 and a quarter as well. We were at
15 8 and a half in 2008. We reduced it to 8 and
16 a quarter in 2011. We reduced it to 8; 2016,
17 to 7 and a half, and now we're at 7 and a
18 quarter.

19 And as Glen said, there are a number
20 of firms -- we're kind of right in the middle.
21 According to the National Association of State
22 Retirement Administrators, the average rate of
23 return -- everyone's different -- but the
24 average is 7.29 percent, and the median is
25 7.28 percent. So, we're kind of right in

1 there. But we do evaluate that every year,
2 and we plan to do so again this spring.

3 REPRESENTATIVE SANCHEZ: Great.

4 Thank you.

5 Thank you, Mr. Chairman.

6 MAJORITY CHAIRMAN SAYLOR:

7 Representative White.

8 REPRESENTATIVE WHITE: Good
9 afternoon. Thank you for being here today.

10 I understand that Pennsylvania's one
11 of only two states in which the pension trust
12 funds do not have their own custodial bank.
13 Ohio is the other state. Additionally, the
14 Treasury Department has not issued an RFP for
15 custodian bank services since 1997. And when
16 we actually spoke to the Treasury Department
17 during their budget hearing, the treasurer
18 stated that PSERS protested the issuing of an
19 RFP in 2015.

20 Could you please explain why?

21 PSERS CIO GROSSMAN: I have no
22 recollection of us protesting that -- of that.

23 REPRESENTATIVE WHITE: So, you'd be
24 in favor of the RFP being issued?

25 PSERS CIO GROSSMAN: Yes. In fact,

1 over the past few years, we've been actually
2 asking for that to occur.

3 REPRESENTATIVE WHITE: Okay.

4 PSERS CIO GROSSMAN: So, we do have
5 documentation of meetings with Treasury --

6 REPRESENTATIVE WHITE: Wonderful.

7 PSERS CIO GROSSMAN: -- with our
8 request.

9 REPRESENTATIVE WHITE: We'd love to,
10 you know, have that for our records as well,
11 if that would be able to be provided.

12 PSERS EXECUTIVE DIRECTOR GRELL: If I
13 could add just a little bit of flavor to that.
14 PSERS' concern is not so much about Treasury
15 being the custodian, it's the fact that we, as
16 a pension fund, don't have any role in that
17 agreement. We've been pressing for several
18 years to try to get, as part of any new
19 custodial relationship, to have service level
20 agreements and to have each of the public
21 pension funds at least have some say in
22 performance.

23 There have been years of problems
24 with the custodial arrangement, not --
25 certainly not just under this treasurer. It's

1 an awkward situation to have -- for us not to
2 have a custodial bank, and, certainly, to --
3 not to have any legal basis for enforcing
4 performance under those custodial
5 arrangements. It becomes even more
6 significant, if, as -- where I'm sure we'll
7 talk about -- there's an effort to try to pool
8 our investment offices. It makes even less
9 sense for somebody else to have those
10 custodial responsibilities in that kind of
11 climate.

12 REPRESENTATIVE WHITE: What kind of
13 savings do you think we could see if an RFP
14 had been issued for these custodial banks for
15 the members of your organizations?

16 PSERS CIO GROSSMAN: I'm not sure we
17 would be able to -- to enumerate a number.
18 But what I do know is I think we could get
19 better service levels than we're currently
20 getting.

21 So, today, PSERS pays 2 million
22 dollars towards the custodial bank through
23 part of an interagency agreement with
24 Treasury. And we also expend about one and a
25 half full-time equivalents managing that

1 relationship because we're not able to get the
2 service levels where we need them to be. So,
3 we actually have to use specific staff to work
4 with the bank and get through the issues we
5 have.

6 REPRESENTATIVE WHITE: Do you have
7 any suggestions in terms of how often you
8 think that that kind of, you know, RFP should
9 be issued, how frequently in terms of a re-bid
10 process?

11 PSERS CIO GROSSMAN: I think it's --
12 every five to ten years makes sense, to at
13 least get a feel for what's in the market.
14 You don't necessarily have to do a full-blown
15 RFP to do that. You can do an RFI to get a
16 feel for what the cost of those services would
17 be.

18 Now, having said that, you really
19 want to work with your current custodial bank
20 because it can be very disruptive to change
21 banks at any point in time. But I think it
22 does make sense to at least scan the market to
23 see what types of rates are being charged.

24 REPRESENTATIVE WHITE: The other
25 topic I'd like to cover, in the governor's

1 budget, he proposes significant increases in
2 funding for investment-related expenses for
3 both systems, but particularly PSERS, where an
4 increase of more than 11.7 million dollars is
5 proposed, which is actually, like, a 51.8
6 percent increase.

7 Can you just talk to the committee
8 about why there's such a large increase that
9 would be needed for PSERS' investment
10 operations?

11 PSERS EXECUTIVE DIRECTOR GRELL:
12 Yeah. From a big picture standpoint, first,
13 keep in mind that all of the expenses are paid
14 out of the fund. No, there's no general fund
15 money involved in any of the operations of
16 either of the pension funds.

17 We believe -- you know, we've been
18 working -- and I'm sure we'll get into this
19 question as well -- in terms of what we can do
20 to reduce external management fees, or those
21 Wall Street fees that we hear about. And one
22 of the ways that we've been successful in
23 pushing those fees down is to bring more asset
24 management internal to the fund. In order to
25 do that, we need more personnel.

1 So, we have been successful. Shortly
2 after I came to the system, we had a request
3 for fifteen additional investment
4 professionals, with an eye toward pushing the
5 external manager fees down. It took about a
6 year and a half, and we got seven of those
7 positions. So, in this year's budget, we're
8 asking for ten additional investment office
9 positions, most of which would be going to
10 bring more asset management internal.

11 The other piece of the increase in
12 the investment-related budget is to enhance
13 our technology by bringing -- bringing online
14 an investment book of record, which will give
15 our investment office much better data upon
16 which to base their decisions, would give our
17 accounting folks much better data in terms of
18 the assets of the fund. So, it's an
19 investment in technology.

20 REPRESENTATIVE WHITE: Thank you.

21 And then briefly, can you just tell
22 me the total dollar amount of investment that
23 PSERS and SERS make in Pennsylvania, in terms
24 of Pennsylvania infrastructure, things of that
25 nature?

1 SERS CIO LEWIS: So, from a SERS
2 perspective, I'll jump in, if you don't mind,
3 while Jim gets his answer.

4 We invested -- approximately 741
5 million dollars of the portfolio's invested
6 there, about 2.8 percent. While we don't have
7 a specific infrastructure focus, we take a
8 look at the best investment opportunities for
9 the fund. And as we've reported out over the
10 years, several of those have resided here in
11 the Commonwealth.

12 REPRESENTATIVE WHITE: Okay. Great.

13 PSERS CIO GROSSMAN: And we -- I can
14 answer this two ways. We manage about 27
15 billion dollars of the assets in Pennsylvania.
16 So, about 40 percent of the portfolio is
17 managed in the home state here.

18 And then, we have private market
19 funds that have deployed 35.5 billion dollars
20 in Pennsylvania companies, of which our
21 share's about 1.9 billion. And when you look
22 at it, the total number of people employed in
23 those companies are about 46,500 people. The
24 total payroll of those companies was 656
25 million dollars.

1 And we have a real estate portfolio
2 that contains 30.9 million square feet of
3 PA-based office rental and warehouse space,
4 and 11,289 apartment, hotel, and condominium
5 units.

6 REPRESENTATIVE WHITE: I guess you
7 guys saw that question coming.

8 PSERS CIO GROSSMAN: Yes.

9 REPRESENTATIVE WHITE: Thank you very
10 much. I appreciate your time.

11 Thank you, Chairman.

12 MAJORITY CHAIRMAN SAYLOR: I want to
13 announce we've also been joined by
14 Representative Gleim, here to observe the
15 hearing as well.

16 With that, we'll move to
17 Representative Comitta.

18 REPRESENTATIVE COMITTA: Thank you,
19 Mr. Chairman.

20 Good afternoon all.

21 First question is about the type of
22 investing in each of the systems.

23 Environmental, social, and governance
24 investing is a term that's used similarly to
25 sustainable investing, socially responsible

1 investing, mission-related investing and so
2 on.

3 And I'm wondering, do either of our
4 systems have such an ESG policy? And if so,
5 what are some examples of the types of
6 investing involved?

7 PSERS CIO GROSSMAN: From PSERS'
8 standpoint, we don't have a specific ESG
9 policy, but any time we hire a manager, one of
10 the disclosures we make to the board is
11 whether the managers we're hearing has an ESG
12 policy. And most of managers we do hire have
13 ESG policies. But the board itself has not
14 adopted a formal ESG policy.

15 SERS CIO LEWIS: Similarly, our board
16 has not adopted an ESG policy. However,
17 through our initial due diligence process, as
18 well as our ongoing monitoring, we ensure that
19 ESG efforts, as well as other operating
20 efforts to add value to the investment, are
21 noted and monitored by the investment team.

22 REPRESENTATIVE COMITTA: Thank you.
23 Regarding the public pension management and
24 asset review commission report, the commission
25 report highlighted some areas that each system

1 could improve and also underscored some bright
2 spots in each.

3 Could you share some of your thoughts
4 on the report and what you're doing in
5 response to those findings?

6 SERS EXECUTIVE DIRECTOR SANCHEZ: We
7 think that the commission spent a lot of time,
8 had a lot of people come in, and did a lot of
9 research to try to come up with some good
10 recommendations for the boards, each of the
11 boards, to consider. And our board has, in
12 fact, been considering those recommendations.

13 We've focused on the broader themes
14 of the report, as opposed to pouring through
15 every single page and comparing facts, just
16 really focusing on the themes and the
17 recommendations.

18 The report came out around December
19 25th, I believe it was. We did not have a
20 board meeting originally scheduled. We
21 scheduled a special meeting in January so that
22 we could introduce the report to the board and
23 discuss with them a strategy, an approach that
24 we might take to review those recommendations,
25 so the board could then come up with a

1 position, if you will, and decide whether they
2 agreed, they generally agreed, whatever the
3 case may be, so that then we could share that
4 with the general assembly as it considers the
5 report's recommendations.

6 We met again earlier this month to
7 discuss. We assigned the recommendations to
8 our various board committees. They're off and
9 running and working on those. We have a
10 retreat scheduled in two weeks, where we
11 continue our work on those recommendations.
12 And hopefully, by April, we would at least
13 have our positions on those that have been
14 made to the general assembly, so that, again,
15 if asked, and even if not asked, we would be
16 happy to provide our thoughts on those
17 recommendations.

18 But we think they were done, again,
19 looking forward to how things could be
20 improved, and that's the spirit within which
21 we're considering them.

22 PSERS EXECUTIVE DIRECTOR GRELL: From
23 PSERS' standpoint, we've followed pretty much
24 the same process, understanding that neither
25 of the funds was heavily involved in the

1 commission's activities at all. In fact, you
2 know, one of our disappointments with the
3 whole process was that the consultant that was
4 brought in spent a total of three hours with
5 PSERS, with our staff. We assembled about
6 fifteen people in our staff. And they spent
7 three hours with us. And at the end of the
8 three hours, we clearly weren't finished with
9 the conversation. And we asked for a
10 follow-up meeting, and that was never granted.

11 Compounding that, at the very last
12 hearing of the commission, we were invited to
13 testify. We were given each forty-five
14 minutes in which to testify, but we were
15 specifically told that they were not
16 interested in hearing about our views of the
17 previous topics that were the subjects of
18 prior hearings, and that we were supposed to
19 limit our conversation to recommendations that
20 we would make to the commission. So, very
21 limited involvement.

22 Moreover, the commission draft
23 report, which was already in process before we
24 testified, was not shared with us at all. In
25 fact, it wasn't even shared with the public

1 prior to taking final agency action on the
2 adoption of the report.

3 And I could go into a whole lot more
4 concerns that we have about the commission and
5 the process. Suffice to say that we're sort
6 of looking at it in the same way as SERS. I'm
7 sure there are some valuable suggestions and
8 best practices in there. There's some good
9 ideas. There are some bad ideas in there.
10 But we committed early on that our board would
11 consider every one of the recommendations.
12 There are over a hundred specific
13 recommendations.

14 We first had a workshop with our
15 board the middle of January. We have a
16 meeting at the end of this week. We're going
17 to have another workshop. And we're dealing
18 with them in groups. We're going to start
19 with the stress testing and the system
20 consolidation recommendations, because trying
21 to tackle all hundred of them at one time just
22 wouldn't be productive.

23 We also have a separate group that's
24 working on transparency issues generally, and
25 they're considering the recommendations

1 dealing with transparency.

2 REPRESENTATIVE COMITTA: Thank you
3 all.

4 And thank you, Mr. Chairman.

5 MAJORITY CHAIRMAN SAYLOR:
6 Representative Dunbar -- or, I'm sorry,
7 Representative Topper. Jumped ahead of myself
8 there.

9 REPRESENTATIVE TOPPER: I would be
10 happy to defer to the more senior member, if
11 he wishes.

12 But, in lieu of that, we'll go ahead
13 and get started.

14 Good afternoon. I have a couple of
15 staffing questions, if I could.

16 The governor's budget recommended ten
17 new positions for both your systems. And,
18 Director Grell, in answering Representative
19 White's questions, you talked -- you spoke a
20 little bit about your ten new investment
21 officer positions.

22 So, will that -- or do you feel
23 that's going to allow more in-house functions?
24 Is that what I heard?

25 PSERS EXECUTIVE DIRECTOR GRELL:

1 Absolutely. Yes.

2 REPRESENTATIVE TOPPER: So, that's
3 going to -- that's going to save us some money
4 in the long run.

5 PSERS EXECUTIVE DIRECTOR GRELL:
6 We're at about 37 percent internally, without
7 any external managers. So, we're hoping to
8 push that.

9 We believe that -- well, I know when
10 we made the case for the fifteen, that we
11 thought that would save, once they're
12 implemented, probably 20 to 25 million dollars
13 a year on external manager fees. So, we think
14 it's a wise investment for us. And it
15 certainly serves the purpose of reducing our
16 outflow of fees to -- to external managers.

17 REPRESENTATIVE TOPPER: Great.

18 And then for SERS, I think the ten
19 positions were for the defined contribution
20 rollout, but that was implemented in January.
21 Is that -- are those still going to be
22 positions that are needed? Or are we kind of
23 shutting the barn door after the horse has
24 already gone out?

25 SERS EXECUTIVE DIRECTOR SANCHEZ: Oh,

1 we've just opened the barn door, and a few of
2 the horses have come in, but the rest of the
3 corral has yet to arrive, if you will.

4 So, we really -- we had a very short
5 time to implement Act 5. Our focus was on
6 getting the computer systems ready, preparing
7 communications so our members could make
8 informed decisions when their right to --
9 their option to elect comes. We were setting
10 up the investment menu, finalizing contracts
11 with those providers of those investment
12 menus, selecting our third-party
13 administrator.

14 But we only implemented those
15 functions that were required come day one or
16 in the first, let's say, ninety days.

17 There's a massive amount of systems
18 work that needs to be done. But there is an
19 "X" amount that needs to be done day one. You
20 need to get out to members, they need to
21 elect, you need to set up the fees with the
22 employers, set up the fee to the third-party
23 administrator.

24 Then we work on the next piece that
25 we expect, purchases of service, people doing

1 refunds or terminating service. So, we kind
2 of scheduled things out so that we could do
3 what needed to be done and kind of chunk it
4 up, if you will, because it couldn't all be
5 done for day one. So, that's just the
6 implementation piece.

7 But as our membership grows and more
8 of our members are Act 5 members, it's a
9 completely different program, different
10 benefit structures, we'll be receiving
11 different questions, so there will be
12 additional needs on the counseling sides.
13 There are many, many additional accounting
14 functions that need to be done on a daily,
15 monthly, and yearly basis. So, we see a lot
16 of need in those -- in those areas.

17 REPRESENTATIVE TOPPER: So, these
18 positions will continue.

19 SERS EXECUTIVE DIRECTOR SANCHEZ:
20 Absolutely.

21 REPRESENTATIVE TOPPER: This isn't a
22 short-term thing.

23 SERS EXECUTIVE DIRECTOR SANCHEZ: No.
24 No.

25 REPRESENTATIVE TOPPER: This is meant

1 to address more long-term concerns than just
2 the rollout of the DC plan.

3 SERS EXECUTIVE DIRECTOR SANCHEZ:

4 Right. We've kind of contracted for the
5 temporary help, if you will, to get the
6 systems work done. But these positions are
7 for ongoing demands that we expect to see.

8 REPRESENTATIVE TOPPER: We've also
9 noticed there's a new position created, the
10 special assistant to the executive director.
11 What will this position entail? Why was it
12 created? And does it combine roles that were
13 eliminated? Or what are we looking at with
14 the new position?

15 SERS EXECUTIVE DIRECTOR SANCHEZ:

16 Actually, that was a very fortuitous event for
17 us. That happened particularly with Act 5
18 coming along. We had an opportunity to bring
19 on board Randy Albright. And Randy Albright,
20 if you may know, was the budget secretary.

21 REPRESENTATIVE TOPPER: I think,
22 yeah. I remember.

23 SERS EXECUTIVE DIRECTOR SANCHEZ:

24 Lots of people do, and that's one of the
25 reasons we're so happy to have Randy on board

1 with us. His experience, decades of
2 experience, working with the governor's office
3 and the general assembly, and working, more
4 specifically, with SERS and PSERS on related
5 issues, proves to be very valuable to us. And
6 as he was preparing to step away from his
7 duties as the budget secretary, he expressed
8 interest in wanting to put his experience to
9 work for the State Employees Retirement Fund.

10 When that idea was brought to me, I
11 was delighted. There is great value in having
12 someone like Randy on board to help us,
13 particularly as we work through all the new
14 things with Act 5. He participated in the
15 final discussions on the Act 5 commission
16 report.

17 And he's also going to be very, very
18 helpful in helping us to shape our program for
19 becoming more actively involved and engaged
20 with the general assembly and the governor's
21 office. That's something that we haven't had
22 a focus on. And that's something we expect to
23 change quite a bit, not to, let's say, promote
24 things but to have a better and more active
25 relationship with the general assembly and the

1 governor's office. And I think that he'll
2 have great value there.

3 REPRESENTATIVE TOPPER: Thank you.

4 Thank you, Mr. Chairman.

5 MAJORITY CHAIRMAN SAYLOR:

6 Representative McCarter.

7 REPRESENTATIVE MCCARTER: Thank you,
8 Mr. Chairman.

9 And thank you all for being here
10 today, for a system that I think has done a
11 remarkable job over its history in providing
12 retirement benefits surely for, you know,
13 hundreds of thousands, if not millions, of
14 Pennsylvanians during its lifetime.

15 If I could focus, for a second, onto
16 the area of benefits. And, currently, what is
17 the amount of money that each system pays out
18 to its retirees and pension benefits each
19 year?

20 SERS EXECUTIVE DIRECTOR SANCHEZ: Oh,
21 sorry. Where's the Jeopardy button?

22 We actually pay about 3.4 billion
23 dollars in benefits a year, 3.1 billion of
24 that are to Pennsylvania addresses.

25 And when we look at that great

1 economic impact that those dollars have -- and
2 PSERS will add theirs, which is quite a bit
3 larger -- it ends up being about a
4 4.8-billion-dollar economic input in the
5 Commonwealth of Pennsylvania, when you take
6 into effect that our annuitants are -- when
7 they make the initial spend of the money, then
8 the businesses where they come and purchase
9 those goods or services, they go out and
10 purchase goods and services, and a third layer
11 where employees of those businesses, as
12 they're getting their pay, then they're making
13 purchases as well.

14 So, when you consider all that, it's
15 about a 4.8-billion-dollar economic impact.

16 REPRESENTATIVE MCCARTER: Okay. And
17 PSERS?

18 PSERS EXECUTIVE DIRECTOR GRELL: For
19 PSERS, the numbers are about double. We pay
20 out about 6.6 billion dollars. And in your
21 materials, you'll see a color-coded map of the
22 Commonwealth that shows where those funds go.
23 91 percent of that money, about 6 billion
24 dollars, goes to Pennsylvania addresses or
25 bank accounts. And the calculated economic

1 impact of the PSERS benefits is 12.7 billion
2 dollars, including 1.7 billion dollars of
3 federal and local taxes.

4 REPRESENTATIVE MCCARTER: And one
5 often reads in the newspapers that, in fact,
6 teacher pension costs, as an example, and
7 state employees' costs are out of control.
8 And they're -- do you consider this to be
9 true? And are the costs of benefits going up?

10 PSERS EXECUTIVE DIRECTOR GRELL:
11 Well, the average PSERS benefit that's paid
12 out is 25,400 dollars. The cost of benefits
13 is actually declining. What's referred to as
14 the normal cost of the pension benefit is
15 declining both at PSERS and SERS. And that's
16 because of the reform measures, which,
17 frankly, have scaled back the benefit level.
18 So, if you're providing lesser of a benefit,
19 the cost of that benefit is less.

20 But the cost of -- the total cost of
21 pension payments is not as affected by that
22 because of the unfunded liability.
23 Seventy-five cents of every dollar of employer
24 contribution that comes to PSERS goes to pay
25 this unfunded liability, that is not

1 technically the cost of providing the current
2 year benefit.

3 REPRESENTATIVE MCCARTER: And in the
4 case of SERS?

5 SERS EXECUTIVE DIRECTOR SANCHEZ:
6 Very similar. The average annuitant, for
7 those who are either superannuated or have an
8 early retirement, is about 24,540 dollars.
9 And I've seen and heard of some of the reports
10 about these annuitants who are getting, you
11 know, six-figure annuities. And that's the
12 case for probably less than one-half of 1
13 percent of our annuitants. And those
14 annuitants have probably thirty to sixty
15 years, in some cases, of service. And they're
16 typically employed by Penn State University,
17 State System of Higher Education, the
18 Administrative Office of the Pennsylvania
19 Courts, so those sorts of positions. They are
20 absolutely the exception and not the rule.

21 REPRESENTATIVE MCCARTER: Thank you
22 very much.

23 So, when we look at the overall
24 benefit that takes place, in a sense, you're
25 saying that approximately what percentage goes

1 back to Pennsylvania's economy overall?

2 PSERS EXECUTIVE DIRECTOR GRELL: With
3 the case of PSERS, it's 91 percent.

4 REPRESENTATIVE MCCARTER: 91 percent.

5 SERS EXECUTIVE DIRECTOR SANCHEZ: And
6 it's the same.

7 REPRESENTATIVE MCCARTER: Same for
8 SERS.

9 And let me just spin very quickly to
10 another question here. What percentage of the
11 Act 5 new employees are expected to join into
12 the defined contribution plans? What is the
13 assumption you're making there?

14 SERS EXECUTIVE DIRECTOR SANCHEZ: I
15 think, on the costing assumptions, when the
16 Act 5 was first costed out, we expected about
17 25 -- about 25 percent of the new Act 5
18 employees selecting another option, either
19 the -- like, the second hybrid plan, and then
20 perhaps another 25 percent electing the pure
21 DC plan. But those were costing figures.
22 We're kind of excited to see what's really
23 going to happen.

24 REPRESENTATIVE MCCARTER: Well,
25 surely, the numbers are small so far, because

1 we've just started into this. But what could
2 you say so far from the numbers we've seen?

3 SERS EXECUTIVE DIRECTOR SANCHEZ:

4 Actually, with Act 5, we sent out about
5 80-some thousand letters to our current
6 members, because they have an opportunity to
7 switch. And I believe we had eleven that did
8 so far.

9 REPRESENTATIVE MCCARTER: Eleven out
10 of the 85,000.

11 SERS EXECUTIVE DIRECTOR SANCHEZ:

12 Yes. And they were all -- they all switched
13 to DC plans.

14 Our new members, the first batch,
15 their forty-five days would be up in the
16 middle of February. We had about twelve or
17 thirteen elect the second hybrid and about
18 twelve or thirteen elect the pure DC. And
19 there were a couple of hundred of them. About
20 28,000 dollars in defined contributions have
21 come in so far, because every single new
22 employee has at least a piece of their benefit
23 in defined contribution.

24 REPRESENTATIVE MCCARTER: Okay. So,
25 it's very small so far.

1 Thank you, Mr. Chairman. I have many
2 more questions but hopefully you'll have a
3 second round.

4 Thank you.

5 MAJORITY CHAIRMAN SAYLOR:

6 Representative Grell, did you have any
7 comments on that at all?

8 PSERS EXECUTIVE DIRECTOR GRELL: On
9 the PSERS side, we haven't gone live with the
10 Act 5 benefit yet, so we don't know what the
11 actual take-up will be.

12 The employer contribution on the DC
13 only is very low, at 2 percent. So, when we
14 were doing preparations, we estimate between
15 10 and 15 percent might opt for the DC only.
16 But experience will tell.

17 MAJORITY CHAIRMAN SAYLOR:

18 Representative Dunbar.

19 REPRESENTATIVE DUNBAR: Thank you,
20 Mr. Chairman.

21 And as a senior member, I -- I have
22 to laugh, because I was a freshman, Glen knew
23 me as a freshman.

24 Anyway, going back to the Act 5
25 commission report we had mentioned a little

1 bit earlier -- and I appreciate your frankness
2 about not having much input and opportunity.

3 And, Ms. Sanchez, you had commented
4 about the board discussing it.

5 Is there going to be any type of
6 formal response at all from either SERS or
7 PSERS?

8 PSERS EXECUTIVE DIRECTOR GRELL: From
9 our standpoint, we are working the board
10 through the recommendations. We had a
11 workshop in January. We're going to have
12 another one. When the board is in a position
13 to make recommendations, we will respond to
14 the specific topics that they have taken
15 action on. We're certainly not going to get
16 them to respond to all hundred recommendations
17 at once, so it will probably be a phased
18 reaction.

19 But, you know, we are both cognizant
20 that we work for boards. And something of
21 this significance, the recommendation of the
22 commission, we certainly have staff views and
23 staff positions on all of the recommendations,
24 but until we get some feedback from our
25 boards, we don't want to go too far out on the

1 limb, given the fact that, in my case, three
2 of the members of the commission are either
3 board members or represented on our board.
4 And I think up now, it's four in Terry's case.

5 So, we'd like the board to speak
6 before we, as staff, go out and speak for
7 them. We will -- we will be responding to the
8 substance of them.

9 REPRESENTATIVE DUNBAR: And a couple
10 of the suggestions brought up, if we can just
11 go through a couple of them right now, just
12 get a little feel for where we're at.

13 Stress testing, there was a
14 recommendation to do an annual stress testing.
15 Is there some cost to that? And it -- does
16 the -- doing it justify the cost that comes up
17 with it? And --

18 PSERS EXECUTIVE DIRECTOR GRELL:
19 Yeah. Stress testing is something that we've
20 been doing for years. Maybe we're not doing
21 it exactly the way the commission thinks we
22 should be doing it. And almost every pension
23 fund in the country has been doing stress
24 testing.

25 Stress testing became the term after

1 Dodd-Frank, and banks were doing all this
2 stress testing. But pension funds, for years,
3 have been trying to determine, okay, what
4 happens if certain variables occur in their
5 investment portfolio.

6 When we did our stress testing last
7 year -- and we do it as part of this asset
8 allocation, asset liability study -- we ran
9 5000 different scenarios and -- to gauge what
10 would happen if sort of the best case happens
11 the whole way down to the worst case, the dark
12 skies.

13 And one of the commission's criticisms
14 was that, well, one of those variables or a
15 series of those variables didn't include what
16 happens if you don't get your annual required
17 contribution or determined -- actuarially
18 determined contribution. And, you know, in
19 our view, it doesn't make sense to spend extra
20 money on another 5000 variables, because, from
21 ten years of experience or fifteen years'
22 experience, we know very well what happens if
23 the annual -- or the actuarially determined
24 contribution isn't made.

25 So, we do stress testing. As best

1 practices in stress testing change, we will
2 change. If the blue ribbon panel of actuaries
3 gets their way and their recommendations
4 become the standard practice, we will do it
5 that way.

6 REPRESENTATIVE DUNBAR: And let's
7 hope that variable never comes to be.

8 Other suggestions about a larger
9 position in passive investments, is that
10 something that could have a great impact on
11 your expected rate of return, following
12 through on that suggestion?

13 PSERS CIO GROSSMAN: I mean, yeah.
14 Any time we do asset allocation and
15 implementation, we're looking to see if active
16 or passive is the best way to implement. Some
17 of the parts of our allocation can only be
18 implemented actively. So, think private
19 equity, private credit, private real estate.
20 They're -- by nature, they're active.

21 One of the things we did in the last
22 asset allocation plan is we asked Aon, our
23 consultant, we asked what if we were to
24 implement everything passively? All right?
25 Just use ETFs. ETFs are available to

1 everybody. Model our portfolio as if it were
2 to be invested in only ETFs. What type of
3 return could we expect?

4 And the return they came up with,
5 they said, Look, if you did that, you could
6 get a return of 5.97 percent versus our
7 current portfolio, which has an expected
8 return of, you know, around 7 and quarter
9 percent. So, we looked at it, we said, Well,
10 we don't -- a percent and a quarter -- almost
11 a percent and a quarter less, and that would
12 cost billions of dollars in return to the
13 system. So, we said, That doesn't make any
14 sense. We backed away from it.

15 But, to the extent circumstances
16 change over time and active managers don't add
17 value, we would move to index, because that's
18 the rational approach. The active managers we
19 have have added value across time and allow us
20 to achieve our target returns and allow us to
21 manage risk as well.

22 So, it's not just the return side,
23 but it's also managing the risk side of the
24 equation.

25 REPRESENTATIVE DUNBAR: And I am out

1 of time, but I did want to make one quick
2 comment. Just I would love to hear, whenever
3 your board does put out some type of a
4 response, their feelings about the cost
5 savings that are listed in the report and
6 their comments about cost matters and you get
7 what you pay for and all the different catch
8 phrases that are used in there. I'd really
9 love to hear the reality of whether these
10 numbers can be obtained.

11 Thank you.

12 MAJORITY CHAIRMAN SAYLOR:

13 Representative Bullock.

14 REPRESENTATIVE BULLOCK: Thank you,
15 Chairman.

16 Good afternoon. How are you doing
17 today?

18 Great.

19 I want to ask you about the diversity
20 in your workforce at both SERS and PSERS.
21 Your commission report makes recommendations
22 regarding diversity.

23 Can you share with us what steps the
24 systems are taking to be more diverse and what
25 benefits of being more diverse include? And

1 also specifically provide the statistics
2 around your diversity and around those
3 efforts.

4 And, second, not just relating to
5 your workforce, but also looking at how much
6 each system has invested with minority or
7 women-owned investment managers and do you see
8 any benefits from doing that?

9 SERS EXECUTIVE DIRECTOR SANCHEZ:
10 Okay. I'll take the workforce part, and then
11 I'm going to ask Bryan to speak to the
12 investment piece.

13 We get a number of reports from the
14 Office of Administration on work flow analysis
15 reports, job group analysis, availability
16 analysis. So, we know where we stand in terms
17 of minority employees and minority staff and
18 staff availability. It's something that we
19 look at and we provide to our supervisors, so
20 that when they are posting positions and
21 recruiting for positions, they can keep in
22 mind if we are underutilized in certain areas.
23 So, that's something that they are mindful of
24 when they go into the recruitment process.

25 We -- speaking of that, we have --

1 actually, the OA has changed it's recruitment
2 process relatively -- in recent past. And we
3 are finding many more candidates that are
4 responding to a number of our positions, and
5 that's good. Because when there are more
6 candidates, there are more minority candidates
7 that are included in that population. So,
8 that's been quite positive in what we're
9 seeing.

10 So, I think it's, you know, a matter
11 of making our staff aware of what our position
12 is, where we stand, making sure that we were
13 -- that we are doing wide enough selection in
14 posting jobs so that we can get the best
15 candidate pool, and, again, basically being
16 mindful of it. The value of diversity, I
17 believe, is that you are getting perspectives,
18 different perspectives and inputs and views
19 that are different. And I see different as
20 something that is good and it can inspire some
21 excellent conversation and you think of views
22 that you may not have otherwise thought of.
23 And, to me, that only results in better
24 outcomes.

25 REPRESENTATIVE BULLOCK: Do you have

1 that the actual statistics for your --

2 SERS EXECUTIVE DIRECTOR SANCHEZ: We
3 do. Let me see here. So, currently, we have
4 about 13.8 percent minority females and 3.1
5 percent minority males on staff.

6 REPRESENTATIVE BULLOCK: And do you
7 have the number for white women?

8 SERS EXECUTIVE DIRECTOR SANCHEZ:
9 Nonminority is 49 percent, so 49 percent
10 nonminority females and 13.8 -- that doesn't
11 make sense -- oh, yeah. I'm sorry. Out of
12 the total population, 13.8 female minority and
13 34 percent male nonminority, and 3.1 percent
14 male minority.

15 REPRESENTATIVE BULLOCK: Okay. Thank
16 you.

17 SERS CIO LEWIS: Representative, from
18 an investment perspective, approximately 9
19 percent of our portfolio is invested with
20 firms that are owned or managed by minorities
21 or women.

22 REPRESENTATIVE BULLOCK: Can you
23 repeat that statistic? I'm sorry.

24 SERS CIO LEWIS: It's approximately 9
25 percent of the overall portfolio. That's

1 broken down with our public equity,
2 fixed-income portfolio, to the tune of
3 approximately 600 million dollars in assets
4 under management. In private equity,
5 approximately 1.5 billion dollars in
6 commitments are to those firms.

7 On the trading activity perspective,
8 about a half of a million dollars, so -- is
9 through public equity commissions through
10 minority- and women-owned brokers.

11 And on the fixed-income side,
12 fixed-income managers traded about 260 million
13 dollars of securities through minority- and
14 women-owned broker dealers.

15 REPRESENTATIVE BULLOCK: Thank you.

16 PSERS EXECUTIVE DIRECTOR GRELL: On
17 the PSERS side, from a staffing standpoint, we
18 are 41.9 percent white male, 44.8 percent
19 white female, 4.5 percent minority male, 8.7
20 percent minority female. And if you look
21 beyond that a little bit, we do very well in
22 terms of women in our workforce. We have 53.5
23 percent of our female coworkers are in
24 management positions compared with the
25 Commonwealth's overall statistic of 19.2

1 percent. So, we have many more in management.

2 It's a little -- we are a little
3 under that in terms of minority populations.
4 Our agency is 13.7 percent minority compared
5 to 14.4 percent Commonwealth-wide. But over
6 half of our minority co-workers are in
7 management positions. So, 51.1 percent of our
8 minority workforce is in a management position
9 compared to 14.9 percent Commonwealth-wide.

10 REPRESENTATIVE BULLOCK: I just want
11 to make sure I got that correct. You said
12 44.8 nonminority female, 4.5 minority male,
13 and 8.7 minority female, was that correct?

14 PSERS EXECUTIVE DIRECTOR GRELL: I
15 believe that's correct. I lost my page, but I
16 believe you're correct.

17 REPRESENTATIVE BULLOCK: I'm sorry.

18 Thank you. I appreciate that.

19 MAJORITY CHAIRMAN SAYLOR:

20 Representative Delozier.

21 REPRESENTATIVE DELOZIER: Thank you,
22 Mr. Chairman.

23 Wanted to ask a little bit about Act
24 5, because obviously the theme, because it was
25 a pretty dense report.

1 One of the questions that I have, for
2 those that were on Act 5 that reviewed it, did
3 all of the members that were reviewing
4 everything going on within both of the
5 systems, were they all highly experienced with
6 investments? Did they -- were they -- did
7 they come from the investment fields? I'm
8 just trying to understand their background
9 when they were making these recommendations.

10 PSERS EXECUTIVE DIRECTOR GRELL:

11 Well --

12 PSERS CIO GROSSMAN: Yeah. I mean,
13 if you look at the main numbers that were
14 listed in the report, it was Dr. Ashby Monk,
15 out of Stanford. I think it was -- he was --
16 oh, are you talking about the commission
17 members?

18 REPRESENTATIVE DELOZIER: Yes.

19 PSERS CIO GROSSMAN: Oh, I'm sorry.

20 PSERS EXECUTIVE DIRECTOR GRELL: The
21 commission members, if you'll recall the way
22 it was structured under Act 5, the governor
23 had one appointee and each one of the four
24 caucuses had one appointee. Going in, we sort
25 of thought it would be an independent group of

1 experts. Frankly -- and, again, I have to
2 caveat, because several of the members of the
3 commission are on our boards. We did not
4 expect that any of our members of -- any of
5 the members of either board would be on the
6 commission that was going to overlook the
7 activities. So, that was little bit of a
8 surprise. Because, you know, now it's
9 resulted in conflict situations where we're
10 not sure what hat certain members are going to
11 be wearing when they consider these -- the
12 same recommendations they made in December,
13 now they're going to be sitting on the board
14 making a vote on those recommendations. So,
15 we were a little surprised by that.

16 We were a little surprised -- I don't
17 think any of the commission members -- well,
18 four of them are either state employees or
19 state officials. There was one who was a
20 retired asset -- or personal wealth manager,
21 but mostly on the individual versus the
22 institutional. We were -- we were a little
23 surprised that there weren't more commission
24 members who had actual experience in
25 institutional money management.

1 REPRESENTATIVE DELOZIER: And that's
2 where -- and just reading some of the
3 backgrounds, it didn't say that they had
4 invested X amount of money to have that
5 investment experience to be able to say to you
6 guys how you should do it better. So, that's
7 where I was just trying to better understand.

8 And I recognize some of the
9 appointees and everything else, because -- and
10 the consultants as well. My understanding was
11 the consultants were more educators versus in
12 the field. Is that correct?

13 PSERS CIO GROSSMAN: Yeah, that would
14 be -- that would be accurate. I mean --

15 REPRESENTATIVE DELOZIER: Okay.

16 PSERS CIO GROSSMAN: -- if you look
17 at Dr. Monk, I mean, he's very well known in
18 the institutional area for governance,
19 collaboration, but not necessarily asset
20 allocation or management fee information.

21 REPRESENTATIVE DELOZIER: Okay. And
22 I was just trying to get a better idea.

23 Because I know -- one of the other
24 things, my other question deals with the
25 states that we're taking a look at. Taking at

1 look at the states that were looked at, and
2 I'm always one to look to see what other
3 states have done. Obviously I like
4 state-to-state comparisons. But I didn't see
5 many of the states that they used equaling --
6 not better or worse, just the same as
7 Pennsylvania. So, the comparison to me,
8 didn't kind of gel as well in the sense of
9 saying, well, such and such a state is doing
10 this better, but they have so many different
11 variances than what Pennsylvania is doing.
12 So, it didn't seem that it was an equal apples
13 to apples.

14 Would you agree with that? Or is
15 that --

16 PSERS EXECUTIVE DIRECTOR GRELL:
17 Yeah. I think that's a fair observation. I
18 think we sort of looked at that as, they were
19 trying to identify best practices in a variety
20 of areas.

21 REPRESENTATIVE DELOZIER: Okay.

22 PSERS EXECUTIVE DIRECTOR GRELL:
23 Regardless of whether it was an exactly apples
24 to apples.

25 REPRESENTATIVE DELOZIER: Okay.

1 PSERS EXECUTIVE DIRECTOR GRELL: And
2 I think we took it with that in mind. So,
3 it's a little bit discounted, based on -- it
4 may not be exactly apples to apples. But if
5 somebody's doing something innovative and it's
6 working, we'd like to know about it.

7 REPRESENTATIVE DELOZIER: Possibly
8 bring it over.

9 PSERS EXECUTIVE DIRECTOR GRELL:
10 Yeah.

11 REPRESENTATIVE DELOZIER: Okay. And
12 my last issue was, you had mentioned you had
13 some good, some bad recommendations. One of
14 the ones that I don't think is necessarily on
15 the good side is the investment oversight
16 committee, establishing that.

17 I guess my confusion comes in to the
18 fact that you guys have money managers. You
19 also have great staff -- as you mentioned,
20 over 30 percent is done internally -- in
21 deciding where to invest.

22 Having a recommendation to establish
23 another committee to tell you how to invest,
24 to me, seems duplicative and something that's
25 not necessarily in the best interest of the

1 taxpayers or the investment oversight.

2 Can you comment on that?

3 PSERS EXECUTIVE DIRECTOR SANCHEZ:

4 Well, we'll be working with our boards to go
5 through that recommendation, really get a
6 better understanding of the whole overall
7 governance structure and what is envisioned
8 for the boards, for this oversight committee,
9 and for the staff themselves. So, we really
10 don't have a vision right now or a position
11 right now, but it's absolutely something
12 that's on the priority list to review and
13 determine what we feel would work.

14 REPRESENTATIVE DELOZIER: I mean, we
15 get criticized time and time again in
16 Pennsylvania of overlap. This, to me, seems
17 like a direct hit on duplicative services for
18 that.

19 Glen, you had some --

20 PSERS EXECUTIVE DIRECTOR GRELL:

21 Well, Terry's a little more diplomatic than I.
22 I think this is one of the worst ideas I've
23 heard of in Harrisburg in about twenty-five
24 years.

25 REPRESENTATIVE DELOZIER: Glad we're

1 on the same page. Okay. That works.

2 PSERS EXECUTIVE DIRECTOR GRELL: I
3 learned something sitting next to you all
4 those years.

5 No. I think -- you know, the issue
6 is, if it was really going to be a committee
7 of five experts, there might be value to it as
8 an advisory. But to have five people
9 appointed by any governor, not this governor,
10 or confirmed by any senate who are going to
11 make decisions affecting the combined fund of
12 80-some billion dollars just seems to me to be
13 a pretty bad idea.

14 REPRESENTATIVE DELOZIER: Okay.
15 Thank you very much. My time is done.

16 PSERS EXECUTIVE DIRECTOR GRELL: And
17 I'm speaking for myself, not my board.

18 REPRESENTATIVE DELOZIER: Okay. Good
19 to know.

20 PSERS EXECUTIVE DIRECTOR GRELL: So
21 far.

22 MAJORITY CHAIRMAN SAYLOR: I'll make
23 a note that I agree with Glen and you and
24 Terry and Representative Delozier on that
25 comment.

1 With that, we'll move to
2 Representative Krueger.

3 REPRESENTATIVE KRUEGER: Thank you,
4 Mr. Chairman.

5 Hi, folks. Thanks so much for
6 joining us here today.

7 So, in less than a decade, we've seen
8 two rounds of pension reforms that have
9 altered the benefit plan designed for both
10 systems, Act 120 of 2010 and Act 5 of 2017.
11 And over one in three employees are now post
12 Act 120, so their benefits have already been
13 reduced. And you've been talking also about
14 the implications of Act 5.

15 While the rate is leveling down in
16 terms of dollars, employer cost are still
17 going up a notch. And I hear this from my
18 superintendents all the time, talking about
19 PSERS. Do you believe that we need more
20 reforms?

21 PSERS EXECUTIVE DIRECTOR GRELL: Do
22 you want to go first?

23 SERS EXECUTIVE DIRECTOR SANCHEZ: I
24 would say it -- it really depends on what
25 you're looking to get out of those reforms.

1 Both Act 120 and Act 5 have come a long way to
2 helping us get to a point where we're paying
3 the bills and address the unfunded
4 liabilities. As Glen has mentioned, the
5 normal cost for new members is now below 2
6 percent on the defined benefit side. So, it
7 really is what is it you're trying to get at,
8 because the benefits seem to have been pretty
9 well managed down to a more reasonable or most
10 reasonable cost, if you will.

11 The reason sometimes costs continue
12 to go up is that perhaps the expected and the
13 actual values are -- don't occur, so the
14 returns might not match, or the member
15 demographics, people are living longer than
16 they expect, so the assumed assumptions are
17 different from the actual experience. And
18 that can then affect the future costs going
19 out. Investment returns can affect those
20 things.

21 So, things never work out exactly as
22 the assumptions say they should. Inflation
23 rates. So, there will be fluctuations, but
24 we're pretty much at the point where we expect
25 our cost to come down, after '22-'23, a slow

1 falling of that. But, again, whenever your
2 actual experience differs from the
3 assumptions, you'll see fluctuations,
4 sometimes they're good and sometimes they're
5 bad.

6 Over the long haul, we hope to be
7 closer to them, though.

8 PSERS EXECUTIVE DIRECTOR GRELL:

9 Yeah. I agree with Terry.

10 The -- it depends on what you're
11 looking for, how you define "reform." Act
12 120, the good thing about that was we scaled
13 back the benefit, and we put the Commonwealth
14 on the trajectory to get to 100 percent of
15 annual funding, which has been achieved. Act
16 5 was geared more toward reducing the future
17 benefit, putting everybody in at least a piece
18 of a defined contribution and thereby shifting
19 the investment risk from totally employer to
20 employee.

21 Neither of those reform measures
22 address the unfunded liability. So, to the
23 extent that there would be any reform
24 measures, they should be geared toward paying
25 down that unfunded liability.

1 In terms of why the employer
2 contribution at PSERS still is going up a
3 little bit, first of all, we're not in a
4 situation where we've been for years where the
5 rate was going up as much as it could under
6 the rate collars, under Act 120. The rate
7 collars are now off.

8 Last year, the employer contribution
9 rate went up less than 1 percent. And that
10 was primarily because -- actually, it was 1
11 and a quarter percent lower than school
12 districts had been told that it would be and
13 when the projections were made. And there
14 were some demographic reasons for that and
15 investment return reasons for that. But the
16 reason it continues to inch up a little bit is
17 because the one variable, which is payroll
18 growth.

19 If we -- we assume, when we're doing
20 our projections, that payroll is going to grow
21 at a certain rate. If payroll doesn't grow as
22 quickly as we think it will be, it takes a
23 higher rate to generate the same number of
24 dollars. And we need the dollars to pay the
25 benefits. So, the rate has to go up a little

1 bit to generate the same number of dollars, if
2 you're applying that rate to a lower total
3 payroll.

4 So, that's the reason. We made an
5 adjustment, based on experience, that the
6 payroll growth rate was not going up as
7 quickly as we thought.

8 REPRESENTATIVE KRUEGER: Thank you.

9 SERS EXECUTIVE DIRECTOR SANCHEZ: May
10 I add one other little point. With SERS, in
11 Act 5, we -- not "we" -- the general assembly
12 instituted kind of a clawback, if you will, of
13 the Act 5 savings. So, in the first few
14 years, what savings that were projected -- and
15 it's somewhere between one-half and 1
16 percent -- and then, say, the last ten years,
17 again, around one-half to 1 percent -- those
18 -- the contribution rate was not -- it's not
19 going back, in other words. Those costs are
20 still there.

21 So, the rates calculated, but those
22 anticipated savings are then added. So,
23 you'll see a little difference there, what
24 might be another half a percent or so, will
25 not come down for PSERS -- for SERS, I'm

1 sorry, because of that.

2 REPRESENTATIVE KRUEGER: Thank you.

3 And, Mr. Grell, I appreciate your
4 point about neither of these reforms actually
5 addressing the unfunded liability. My
6 understanding is that's one of the biggest
7 challenges we face. And every time we saw a
8 new bill around pension reform, that's one of
9 the questions that I had for our staff, how
10 much will this do to address the unfunded.

11 So, thank you for your answers.

12 MAJORITY CHAIRMAN SAYLOR: If I can
13 ask and follow up on Representative Krueger's
14 questions. We know you're -- neither of you
15 are fully funded at this point. Do you guys
16 have projections as to when you expect --
17 barring any catastrophic economic downturn,
18 when you think you may be fully funded again?
19 The last time you were fully funded, I think,
20 was 2000, and then the big economic downturn.

21 Any projections at all?

22 SERS EXECUTIVE DIRECTOR SANCHEZ:

23 We're about 2043.

24 PSERS EXECUTIVE DIRECTOR GRELL: From
25 PSERS' standpoint, this is probably the chart

1 you're thinking of. 2000 is when the fund was
2 123.8 percent funded. So, you see how
3 quickly, from 2000 to 2016, it took us.

4 The good news is that the red has
5 stopped and we've turned the corner, mostly
6 because of the full actuarial funding each
7 year, but it's a slow climb. I mean, we
8 projected out to 2026, and it only gets up to
9 66.4 percent. So, it didn't go down in one
10 year, and it's not going to go back up in one
11 year. But we're at least on the path to get
12 there.

13 SERS EXECUTIVE DIRECTOR SANCHEZ:
14 We'll hit actually 80 percent, which is
15 sometimes considered kind of the bellwether of
16 a somewhat healthy system. And we expect to
17 hit that around 2030.

18 PSERS EXECUTIVE DIRECTOR GRELL: And
19 the number, I've just be told, for full
20 funding, 2040, 2042.

21 SERS EXECUTIVE DIRECTOR SANCHEZ:
22 Around the same.

23 MAJORITY CHAIRMAN SAYLOR: About the
24 same time for both of you. Okay. Thank you
25 very much.

1 And we'll move to Representative
2 Lawrence.

3 REPRESENTATIVE LAWRENCE: Thank you,
4 Mr. Chairman.

5 And so, I'd like to talk a little bit
6 more about the unfunded liability particularly
7 in front of SERS. So, Director Sanchez, the
8 assumed rate of return for the State Employee
9 Retirement System I believe is 7.25 percent
10 per year.

11 SERS EXECUTIVE DIRECTOR SANCHEZ:
12 Correct.

13 REPRESENTATIVE LAWRENCE: So, what
14 was the actual rate of turn realized by SERS
15 last year?

16 SERS EXECUTIVE DIRECTOR SANCHEZ:
17 Last year was a minus of -- unaudited figure
18 of minus-4.6 -- 4.3, 4.6.

19 REPRESENTATIVE LAWRENCE: Okay. So,
20 the assumed rate was 7.25 percent growth; in
21 reality, we lost 4.3 percent. So, by missing
22 the assumed rate of return by 11 and a half
23 percent --

24 SERS EXECUTIVE DIRECTOR SANCHEZ:
25 Um-hum.

1 REPRESENTATIVE LAWRENCE: -- how much
2 did that add to the unfunded liability for
3 SERS?

4 SERS EXECUTIVE DIRECTOR SANCHEZ:
5 We -- that was a loss of about 3.36 billion
6 dollars, because you need -- we look at -- we
7 expected to gain, as you said, 7 and a
8 quarter, but we lost 4. When you add those
9 together, it's about 3.3 billion dollars.
10 That averages -- we would smooth that in at
11 about 660 million dollars a year over the five
12 years. So, it's added about 3.3 billion
13 dollars.

14 REPRESENTATIVE LAWRENCE: 3.3
15 billion, with a B.

16 SERS EXECUTIVE DIRECTOR SANCHEZ:
17 Yes, with a B.

18 REPRESENTATIVE LAWRENCE: So, my
19 understanding is that with last year's losses
20 factored in, SERS is about 56 percent funded
21 right now. Is that about accurate?

22 SERS EXECUTIVE DIRECTOR SANCHEZ:
23 That is.

24 REPRESENTATIVE LAWRENCE: All right.
25 So, earlier in your remark you stated that

1 38.4 billion dollars was paid to SERS
2 annuitants last year. And we've established
3 there was a negative investment return. So,
4 how much money did SERS receive from employee
5 and employer contributions last year?

6 SERS EXECUTIVE DIRECTOR SANCHEZ: We
7 received, from the members, about 394 million
8 dollars in member contribution, and we
9 received 2.2 billion dollars in employer
10 contributions last year.

11 REPRESENTATIVE LAWRENCE: So, SERS
12 received about 2.6 billion last year and paid
13 out about 3.4 billion. Right?

14 SERS EXECUTIVE DIRECTOR SANCHEZ:
15 Correct.

16 REPRESENTATIVE LAWRENCE: So, that
17 means SERS paid out 800 million dollars more
18 than it took in, on top of a 3-billion-dollar
19 investment loss.

20 All right. So, I mean, I realize
21 investment -- investing's a long-term
22 proposition. When you invest, there's up
23 years, there's down years. And, you know,
24 candidly, at least in my view, the state
25 employee retirement system is only 56 and a

1 half percent funded today, largely because of
2 tremendously short-sighted decision made by
3 the general assembly during the Ridge and
4 Rendell years. That's where the blame lies.
5 Right?

6 It certainly not -- you know, I think
7 it's important to mention it not with the
8 employees fault. Right? They didn't --

9 SERS EXECUTIVE DIRECTOR SANCHEZ: Not
10 at all.

11 REPRESENTATIVE LAWRENCE: They've
12 paid every dime they were ever asked to put
13 into the system.

14 SERS EXECUTIVE DIRECTOR SANCHEZ:
15 Um-hum.

16 REPRESENTATIVE LAWRENCE: But I
17 think, at a very minimum, it's greatly
18 troubling to me that we paid out more than --
19 almost a billion dollars more in benefits last
20 year than we brought in, on top of the
21 significant loss.

22 So, I want to be clear. I'm not
23 suggesting that the pension fund is insolvent.
24 I'm not suggesting that it's going broke
25 tomorrow. But the Pennsylvania taxpayer is

1 ultimately on the hook for any shortfall in
2 the pension fund. Am I correct?

3 PSERS EXECUTIVE DIRECTOR SANCHEZ:

4 Correct. On the defined benefit side, yes.

5 REPRESENTATIVE LAWRENCE: I just -- I
6 just -- I guess I'd encourage all of us in the
7 room to feel the weight of that.

8 Thank you, Mr. Chairman.

9 MAJORITY CHAIRMAN SAYLOR:

10 Representative Kim.

11 REPRESENTATIVE KIM: Good afternoon.

12 Thank you, Mr. Chairman.

13 So, I'm going to talk to Glen Grell,
14 not as executive director. We're by ourselves
15 in a room right now, nobody's here, the
16 cameras are not here. Let's say we did a
17 Brexit and we voted again on Act 5-2017, and
18 we voted not to implement it, but instead we
19 put forth another pension reform bill.

20 What would have you put in from your
21 past bills, when you were a state
22 representative, to this bill that would give
23 us true reform?

24 PSERS EXECUTIVE DIRECTOR GRELL:

25 Well, I mean, part of the legislation that I

1 was promoting years ago, in a prior life,
2 involved plan design changes, most of which
3 were encompassed in Act 120, when we rolled
4 the multiplier back and changed the vesting
5 and did those things.

6 The really innovative thing that we
7 did -- or you all did in Act 120 was to
8 institute shared investment risk, this concept
9 that if the funds don't hit their bogey in
10 terms of assumed rate of return for over a
11 three-year period, ultimately over a ten-year
12 period once it's rolled in, then the employee
13 contribution rate has to go up, to help fill
14 that hole. That was a really innovative thing
15 that was done in 2010.

16 I think a better approach in 2017
17 would have been to build on the shared risk,
18 maybe expand the parameters of the shared
19 risk. Nobody knew about shared risk because,
20 fortunately, both funds hit their assumed rate
21 of return for those -- for six years under Act
22 120, so it was never triggered. But that's a
23 way to take the certainty of a defined benefit
24 structure and instill the concept of shared
25 investment risk that you find in a defined

1 contribution plan.

2 The other idea that we were talking
3 about a lot in prior years was to do something
4 specific to address the unfunded liability.
5 One scenario was to take -- make a general
6 fund or a Commonwealth commitment to borrow
7 some money at low interest rates at the time
8 and put them into the pension funds as a
9 penance for the years of underfunding perhaps,
10 but as a way to really, truly address the
11 unfunded liability.

12 You know, as interest rate market
13 changes, maybe the time has passed that -- for
14 that to work. But if we had borrowed, in
15 2010, 3 or 6 billion dollars at very low
16 interest rates, and you follow the rate of
17 return that we've had over the past ten years,
18 that would have been a net gain to both
19 systems. Plus, it would have taken some of
20 that debt off of the pension fund and put it
21 on the general fund balance sheet, where it
22 really is anyway.

23 REPRESENTATIVE KIM: Right. And what
24 I respected you, when you were proposing this,
25 you really did your homework. You talked to

1 all sides. And it was a very controversial
2 bill because, you know, it was hard. And I
3 think in -- one of your bills said that you
4 would borrow, was it a billion dollars? Was
5 that --

6 PSERS EXECUTIVE DIRECTOR GRELL: It
7 was 10 billion.

8 REPRESENTATIVE KIM: It was 10
9 billion dollars. Yeah.

10 PSERS EXECUTIVE DIRECTOR GRELL: I
11 think it was 6 for PSERS and 4 for SERS,
12 something like that.

13 REPRESENTATIVE KIM: So, if we had
14 done that, do you think we'd be in a better
15 spot right now?

16 PSERS EXECUTIVE DIRECTOR GRELL: I
17 mean, in retrospect, yeah, probably, because
18 the investment markets cooperated. Interest
19 rates stayed low, so we would have paid
20 relatively low cost -- or the general fund
21 would have paid generally low cost on that
22 borrowing, and the performance of the funds
23 over that particular period outperformed. So,
24 it would have been a net gain.

25 REPRESENTATIVE KIM: Thank you so

1 much.

2 PSERS EXECUTIVE DIRECTOR GRELL: We'd
3 still have a debt, though.

4 REPRESENTATIVE KIM: Right. Thank
5 you so much.

6 Thank you, Mr. Chairman.

7 MAJORITY CHAIRMAN SAYLOR:

8 Representative Davis.

9 REPRESENTATIVE DAVIS: Thank you.

10 And welcome.

11 My question is just around
12 economically targeted investment. I was doing
13 some research, and I've seen a number of
14 places, like Wisconsin, New York, California,
15 have made a series of economically targeted
16 investments.

17 Does PSERS or SERS have a strategy
18 around these types of investments?

19 PSERS CIO GROSSMAN: We don't have a
20 strategy around those types of investments.

21 SERS CIO LEWIS: We do not have a
22 strategy at this time.

23 REPRESENTATIVE DAVIS: Would you
24 consider developing one or looking into one?

25 SERS CIO LEWIS: What I would say

1 is -- and, understanding, when you think about
2 the fiduciary responsibility of trying to meet
3 the expected return that's established, you
4 have to balance the available investments at
5 the time of the investment recommendations to
6 our boards with that. And so, the -- the
7 point would be, we definitely can take a look
8 at those opportunities as a part of that
9 overall process. But within the SERS
10 investment process, staff and consultants will
11 look for, again, the best risk adjusted
12 opportunities for the portfolio that are
13 available at that time, and then we ultimately
14 make those recommendations to our board.

15 Our board makes the final decision.
16 And if they were so inclined or wanted a more
17 specific focus within the investment policy
18 statement, then that's where we would need to
19 have that conversation, to make sure that we
20 would be meeting their objectives.

21 REPRESENTATIVE DAVIS: Okay. I would
22 just encourage you guys to take a closer look
23 at it and not to fall back on just the
24 fiduciary answer. I think -- I think there's
25 a lot of good investments that have come out

1 of this strategy, and I would encourage you
2 guys to take a serious look at it and not just
3 kind of brush it aside.

4 PSERS EXECUTIVE DIRECTOR GRELL: If
5 you could pass along the states that you
6 mentioned, so that we make sure we look at the
7 same information you've looked at, we'd be
8 happy to look at it.

9 REPRESENTATIVE DAVIS: Will do.

10 PSERS EXECUTIVE DIRECTOR GRELL:
11 Thank you, Representative.

12 MAJORITY CHAIRMAN SAYLOR: Second
13 round to Representative James.

14 REPRESENTATIVE JAMES: Softball, if
15 you will, gentlemen, for PSERS.

16 You operate a -- actually two
17 post-employment health care programs, I
18 believe.

19 PSERS EXECUTIVE DIRECTOR GRELL:
20 Um-hum.

21 REPRESENTATIVE JAMES: Can you give
22 us a brief overview of those? And also
23 include in your comments what benefits are
24 paid for retired school employees under those
25 health care plans, please.

1 PSERS EXECUTIVE DIRECTOR GRELL:

2 Well, we have a program called the Health
3 Options program. It's legislatively
4 authorized since 1994. It is primarily for
5 Medicare post-65 employees, because, in
6 Pennsylvania, most school employees who retire
7 with sufficient service stay on their local
8 school district plan until they hit age 65.
9 That's where the need exists. And PSERS,
10 years ago, stepped in to fill that need.

11 So, it's -- we also have a pre-65
12 group coverage, which isn't really heavily
13 subscribed, because there's not a huge need
14 for it. But most of the membership is in the
15 post-65. We have about 117,000 participants.
16 We solicit plan designs from all the different
17 qualified carriers in Pennsylvania. So, we
18 provide the members of Health Options a series
19 of options, and they choose which plan design
20 they want, and they pay the premium for it.
21 So, that's the program.

22 We also have something called premium
23 assistance, which was also approved by the
24 legislature. And it allows someone who has --
25 who's eligible, typically you needed

1 twenty-four and a half years of service,
2 credited service, before you retired, and you
3 need to be either enrolled in one of our plans
4 or in the school district plan. If you meet
5 that eligibility requirement, you get a
6 hundred dollars per month toward your premium.

7 So, they're privately paid, privately
8 supported group insurance policy -- or
9 programs, but there is this subsidy through
10 the premium assistance program. And the cost
11 of that premium assistance is spread out over
12 all employers. I think this year it accounts
13 for .83 percent of the employer contribution
14 rate that school districts pay.

15 REPRESENTATIVE JAMES: Okay. Thank
16 you.

17 This is for both groups. Working our
18 way back to the Act 5 commission report, if we
19 could. One of the intriguing recommendations
20 was to establish a consolidated central
21 pension investment office. For the moment,
22 never mind who's advising the investments.
23 But, can you talk about the concept of merging
24 the assets of your two groups, and whether or
25 not that is a great idea or not?

1 SERS EXECUTIVE DIRECTOR SANCHEZ:

2 Well, again, our board is still working
3 through those concepts and facts, SERS and
4 PSERS. Our staffs are working together to
5 see, if this is something that's going to
6 happen, how might it work best.

7 But I don't know that we're talking
8 about combining funds, actually, if you will.
9 It's more the operations. There are, again --
10 bring up that word -- fiduciary reasons why
11 actually commingling the funds may not be
12 doable. But consolidating the operation,
13 which I think is the main focus of what the
14 recommendations were, it's something that
15 we're taking a look at, to determine what
16 savings we may, in fact, be able to get out of
17 that and how our boards could still maintain
18 fiduciary responsibility and do their duties,
19 but perhaps find some savings and efficiencies
20 if we consolidated the operation.

21 So, no conclusions at this point.
22 But we're working together with, again, the
23 agencies, and then we'll take some
24 recommendation to our board for them to
25 consider and see what we might find, see what

1 might work or not.

2 PSERS EXECUTIVE DIRECTOR GRELL:

3 Yeah. We've actually been talking about this
4 for several years. Governor Wolf has
5 mentioned it in prior budget addresses. And
6 it's something that we've looked at. But the
7 prior approach was to see what could be done
8 without the need to go in to change the
9 retirement code. Now there seems to be a
10 focus on -- and there were many, many legal
11 obstacles to being able to do that.

12 We've accomplished some things in
13 terms of sharing deal flow and our CIOs get
14 together on a regular basis and talk about
15 what they're doing to try to get some
16 economies there. But much heavier lift, would
17 require legislation.

18 And as Terry said, nobody that I'm
19 aware of is talking about actually combining
20 the two funds.

21 And it's -- you know, we think that
22 if we put our smart investment people together
23 with SERS' smart investment people, there
24 probably are some economies of scale and some
25 efficiencies that could be achieved. Nobody's

1 really quantified that yet. But, as Terry
2 said, we've been talking. We've been meeting
3 with our senior group for -- like, every two
4 weeks all this year, and we'll continue to do
5 that.

6 But we have two very different funds,
7 two very different boards. But I think the
8 keys that you ought to keep in mind on any
9 ideas, our two fiduciary boards have to
10 continue to have the important roles of
11 determining the asset allocation and
12 monitoring the investments. They have to have
13 their own chief investment officer who will
14 advise them and monitor those things with
15 them.

16 Beyond that, if the boards give
17 direction to a pooled investment office that
18 consists, as I said, of all of our smart
19 professionals in the investment office, we
20 probably can gain some efficiencies. And
21 we're trying to look for a structure that
22 would take the role of the SERS board and the
23 PSERS board and maybe create a subset of --
24 like a shared governance kind of committee
25 that would set the budget and do things like

1 that for this pooled investment office.

2 Whether they become SERS employees,
3 PSERS employees, or stay and we come up with
4 some sort of shared employee paradigm,
5 that's -- those are the kind of weeds that
6 we're trying to push through.

7 But we think there are some
8 efficiencies that might be gained, if -- you
9 know, we've got to present it in such a way
10 that both of our boards buy into it and that
11 it's acceptable to the legislature and
12 achieves the kinds of things that the
13 commission talked about in terms of
14 efficiencies and economies.

15 REPRESENTATIVE JAMES: Clearly, you
16 have been thinking about it. Thank you much
17 for that, actually, two excellent answers.

18 Thank you, Mr. Chairman.

19 MAJORITY CHAIRMAN SAYLOR:
20 Representative White.

21 REPRESENTATIVE WHITE: Thank you,
22 Mr. Chairman.

23 So, I was going to try to ask you a
24 couple other questions regarding the custodian
25 bank issue we were talking about earlier. You

1 had mentioned that you're concerned about the
2 service levels by the current provider.

3 Could you just share with us some of
4 those concerns?

5 PSERS CIO GROSSMAN: I mean -- you
6 know, the day-to-day administration with the
7 custodial bank, there's certain service levels
8 that we would expect to get that we are not.
9 I mean, I can't -- I can have one of my staff
10 people that actually deals with the custodian
11 talk to you about that, if you'd like, in more
12 detail.

13 REPRESENTATIVE WHITE: Okay. I can
14 talk to them afterward. That's fine. Thank
15 you.

16 PSERS CIO GROSSMAN: I mean, when you
17 step back and look at the custodian, what does
18 a custodian do? It holds securities. It
19 collects interest and dividends and settles
20 trades. That's BNY Mellon, that's not the
21 treasurer. The treasurer -- Treasury is in
22 the middle of that discussion between the funds
23 and the custodial bank and essentially is
24 negotiating an agreement on behalf of the
25 funds. Whereas, the funds themselves have

1 fiduciary responsibility for the assets and
2 the management of the funds. So, that sort of
3 separates that today.

4 And without the necessary service
5 level agreements, we don't have any
6 contractual right to deal with the bank.

7 REPRESENTATIVE WHITE: So, would you
8 say that your primary reason that you would
9 want to have input is mostly for the service
10 levels? Or are there other aspects that you'd
11 like to have input on?

12 PSERS CIO GROSSMAN: The service
13 levels would be the biggest aspect. We would
14 be able to contract directly and hold the bank
15 accountable for not providing the service
16 levels. Again, we're paying 2 million dollars
17 plus a year. We're not getting the service
18 levels that we would expect to get with that
19 type of contract.

20 PSERS EXECUTIVE DIRECTOR GRELL: And
21 if I can add, because, you know, we're not a
22 direct party to the contract, we don't really
23 have a good idea of whether 2 million dollars
24 is an appropriate amount for us to be paying
25 for that level of service.

1 PSERS CIO GROSSMAN: Right. And some
2 of the issues would be even transparency into
3 the bank's own procedure. We're not
4 necessarily getting what we feel we need from
5 a transparency standpoint from the bank.

6 REPRESENTATIVE WHITE: And have you
7 had conversations with our Treasury department
8 to basically tell them to ask the custodian to
9 improve? Or --

10 PSERS CIO GROSSMAN: Yes, we have.
11 We've met with them, I think it was a year or
12 two -- is it two years ago -- about two years
13 ago.

14 REPRESENTATIVE WHITE: And you have
15 yet to see any improvement.

16 PSERS CIO GROSSMAN: No, we have not.
17 And, in fact, we've essentially gotten the
18 response that this is -- you know, it went
19 from service level agreement to, well, maybe
20 we'll give you some description of what we're
21 going to do for you, but we don't want to be
22 held, necessarily, accountable to that.

23 REPRESENTATIVE WHITE: Okay. I guess
24 along those lines as well, can you just talk
25 to us about what other benefits, I guess,

1 would come along with having your own
2 custodial bank, especially now that Act 5 is
3 directing the pension systems to select the
4 custodian banks? Does that make sense?

5 PSERS CIO GROSSMAN: I mean, I can
6 say that essentially some of the benefits we
7 would get from having our custodial bank would
8 be we would get better service delivery. If
9 you think about it, it's PSERS that has
10 issues, SERS that has their own issues,
11 Treasury that have their own issues. They may
12 not be similar.

13 We run a -- you know, we have more
14 accounts. We manage money internally. We run
15 a more sophisticated investment program. So,
16 I think we get better services. We get better
17 accountability from the bank. The bank would
18 then be accountable to us because we'd be a
19 direct -- we'd have the direct contract with
20 the bank. We believe we'd get improved
21 operational efficiencies and controls out of
22 that.

23 So, we think there's a lot of
24 benefits that could come from having a direct
25 contract. Plus, to some extent, it's almost

1 unfair to Treasury to have to negotiate on our
2 behalf as a middleman in this. Right?
3 Because we have to go to them, and they have
4 to go and try to push for the contractual
5 changes. Whereas, they have a lot of other
6 duties that they're responsible for.

7 PSERS EXECUTIVE DIRECTOR GRELL: And,
8 in addition, we may be paying for things that
9 we really don't need, that we can do
10 internally without the need of a custodian.
11 But unless we're actually part of the drafting
12 of the RFP and creating the services, it's
13 hard for us to know what we're paying for.

14 REPRESENTATIVE WHITE: Is there
15 anything anyone else would like to add to
16 that?

17 PSERS CIO GROSSMAN: One other thing,
18 under the new law for the DC plan, we actually
19 get to select our custodial bank. So, there
20 would be additional efficiencies there as
21 well, where you can take the DC assets and the
22 DB assets and pick one custodial bank for
23 that, rather than having them separated. So,
24 we gain efficiencies that way as well.

25 REPRESENTATIVE WHITE: Okay. Do you

1 think that it impacts any fiduciary
2 responsibilities that you have on behalf of
3 our pensioners?

4 PSERS CIO GROSSMAN: I mean,
5 ultimately, the pension board is fiduciary for
6 the assets and the investments, so, yeah, to
7 some extent it does, because we don't
8 necessarily control the custodial arrangement.

9 PSERS EXECUTIVE DIRECTOR GRELL: If
10 there's an error that's made and we lose
11 something as a result of that, that's
12 ultimately a loss that our members suffer, or
13 if there's an additional fee that we have to
14 pay, that comes out of the pockets of our
15 members and the fund.

16 REPRESENTATIVE WHITE: Okay. Thank
17 you very much. I appreciate your time.

18 MAJORITY CHAIRMAN SAYLOR:
19 Representative Comitta.

20 REPRESENTATIVE COMITTA: Thank you,
21 Mr. Chairman.

22 So, Rep. Kim's question got me
23 thinking. So, I have question along the lines
24 of your thoughts and advice to the
25 legislature.

1 So, in an effort to learn from our
2 mistakes regarding legislative policy
3 decisions that were to not fully fund the
4 pension liability and responsibilities have
5 lead to 60 percent of Pennsylvania's unfunded
6 pension liability, at about 38 billion, and
7 the other 40 percent of the unfunded pension
8 liability came from -- as a result of the
9 great recession.

10 So, what advice do you have for
11 legislators, moving forward, regarding policy
12 decisions to reduce the unfunded pension
13 liability and in preparation for the next
14 recession?

15 SERS EXECUTIVE DIRECTOR SANCHEZ:
16 First and foremost, you know, the maintaining
17 of full funding of the systems. This
18 administration and this general assembly has
19 done so for what will be the forth year in a
20 row for us. I can't stress enough how
21 important that is. Had we not had funding
22 deferrals in the past, SERS would have had 8
23 billion dollars less in its unfunded
24 liability, 8 billion, with a B, dollars less.

25 So, lessons learned. Hopefully,

1 again, we are all, I believe, of the right
2 mind now, but we don't know that that will
3 continue into the future. So, putting in
4 something in place that would help to ensure
5 that that full funding continues to take place
6 as well as, you know, perhaps a dedicated
7 funding source.

8 We are fiduciaries. And, first and
9 foremost, adequacy is important. You know, we
10 need to be able to pay those promised benefits
11 over a period of a wide range of scenarios.
12 And that kind of gets back to the stress
13 testing a little bit. Not that it needs to be
14 or must be legislated, but it is an important
15 thing to do. And that's information that the
16 systems can give back to the general assembly
17 so that you can see, if these things change,
18 certain scenarios or situations change, what
19 it would mean to the contribution
20 requirements. And then, put some sort of plan
21 in place.

22 I think that's the whole point of the
23 stress testing, by the way, is to see what
24 could happen under certain scenarios, and the
25 most important thing, then, is to plan for it,

1 what can we do about it. And to ensure
2 consistent funding, I think, is the most
3 important thing that could be done at this
4 point.

5 PSERS EXECUTIVE DIRECTOR GRELL.

6 Yeah. I mean, building on that, it took a
7 long time, under Act 120, with the rate
8 collars, to get from 27 percent of paying the
9 ARC to a hundred percent, as Terry said, going
10 on into the fourth year. But, I analogize it,
11 when I'm out speaking to groups, is, you know,
12 assume you didn't pay your mortgage in full
13 for fifteen years, and you, all of a sudden,
14 say, I'm going to start paying my mortgage,
15 full payments. I'm not going to pay 27
16 percent. I'm going to pay 100 percent. Well,
17 you still owe what you paid -- what you didn't
18 pay over those fifteen years.

19 So, you can change the plan design
20 all you want, but it's not going to eliminate
21 the fact that there's this big hole of money,
22 the unfunded liability, that was created. So,
23 the way to really address it is to try to come
24 up with some way to make a payment in addition
25 to your full mortgage payment, whether that's

1 a dedicated funding stream, whether that's an
2 infusion of cash.

3 You know, by -- because we have a 7
4 and a quarter percent assumed rate of return,
5 when you don't fund the plan, you're basically
6 borrowing money from the pension fund at 7 and
7 a quarter percent. You could probably even,
8 in today's climate, borrow at less than that.

9 So, the focus on any future reform
10 measures ought to be on trying to -- whether
11 it's -- there's an idea out for a rate
12 stabilization fund, where some money would be
13 put aside, like -- similar to a rainy day
14 fund, where if there's an operating reserve
15 from the Commonwealth, from the general fund,
16 that it would be -- a portion of it would go
17 into the rainy day fund, a portion would go
18 into a rate stabilization fund. And that
19 could be used to either pay down the debt or
20 to subsidize -- further subsidize the school
21 districts, who are bearing the brunt of a 34
22 percent employer contribution rate.

23 You know, God bless them. They've
24 made the tough decisions at the school
25 district level to raise property taxes so that

1 they can meet their obligations to their
2 current and future employees. And if the
3 Commonwealth could do something like maybe
4 picking up a larger share of the pension
5 contribution from the school district level,
6 that would certainly help ease the burden on
7 the districts.

8 REPRESENTATIVE COMITTA: So, this is
9 a budget hearing, but do you think that a
10 future hearing dedicated to how do we avoid
11 mistakes or learning from the past and
12 planning for the future kind of thing with the
13 pension plan, is that something that would be
14 beneficial?

15 PSERS EXECUTIVE DIRECTOR GRELL:
16 Well, I mean, we're always available to come
17 over to talk to individuals or groups or
18 anybody that thinks they have an idea that
19 might help the situation.

20 I wouldn't have sort of a
21 free-ranging hearing that doesn't have any
22 guideposts to it. But if there are specific
23 ideas that you want to kick around in a public
24 setting, we're happy to do that.

25 Keep in mind, though, when we help

1 legislators assess various ideas, often times
2 it does cost us money, not just staff time,
3 but also actuarial, outside actuarial fees.
4 We spent 1.2 billion -- 1.2 million dollars,
5 excuse me, 1.2 million dollars over the three
6 years, 2015, '16, '17, running various
7 scenarios leading up to the passage of Act 5.
8 So, be a little mindful of that, as I'm sure
9 you would be.

10 REPRESENTATIVE COMITTA: And thank
11 you, Mr. Chairman.

12 MAJORITY CHAIRMAN SAYLOR:
13 Representative Boyle.

14 REPRESENTATIVE BOYLE: I think we
15 know that cash flow for pension systems is
16 very important. Can you please describe the
17 magnitude that your cash flow situation has on
18 the overall system?

19 PSERS CIO GROSSMAN: Yeah. I mean,
20 you know, I think what you're talking about
21 negative external cash flow, so the benefits
22 we pay in excess of the contributions that we
23 receive from both employer and employee. And
24 it can have a significant impact, especially
25 when the number gets very large, because that

1 creates liquidity issues for the fund.

2 So, if you look, right after the
3 financial crisis, our negative cash flow was
4 around 8 percent of the fund, meaning if we
5 earn nothing in that year, we would have to
6 sell 8 percent of the assets to meet the
7 obligations of the system.

8 And it was a really big deal during
9 the fifteen years that we weren't being fully
10 funded on the actuarial rate, and it did have
11 significant impacts specifically after the
12 financial crisis, where the assets fell
13 significantly and there was no plan on where
14 the funding, the employer funding, was going
15 to come from in the future. That didn't come
16 until later, 2010, with the legislation. And
17 it did have a material impact on how we
18 thought about asset allocation and how we
19 thought about how much risk we were willing to
20 take until there was really a plan in place to
21 fund the system and we could see it actually
22 working.

23 REPRESENTATIVE BOYLE: I know you
24 talked a little bit about allocation, but can
25 you expand a little more on allocation as it

1 pertains to the cash flow situation?

2 PSERS CIO GROSSMAN: Well, when you
3 go back to entering the financial crisis, we
4 were -- we had a portfolio that had about 70
5 percent of the assets in equities. Equity
6 fell 50 percent, so we top-ticked in assets at
7 about 70 billion dollars at the end of one
8 of -- I think it was October. And we fell all
9 the way down to 42 million dollars. So, you
10 saw, as the assets fell, then negative cash
11 flow, as a percentage of the assets, really
12 grew large.

13 During that time, we looked and said,
14 Well, we don't know what the market's going to
15 do going forward, but we do know we couldn't
16 afford to have another hit like that with the
17 equity risk we were carrying. So, we really
18 reduced the equity risk and tried to
19 re-balance the portfolio into more fixed
20 income, more real assets, so more diversified.
21 So, if the equity market did hit another
22 pothole quickly, we had other things that
23 hopefully were working and that the assets
24 wouldn't necessarily contract as much going
25 forward.

1 REPRESENTATIVE BOYLE: Thank you.

2 PSERS CIO GROSSMAN: Sure.

3 PSERS EXECUTIVE DIRECTOR GRELL: On
4 the cash flow, I'd just point your attention
5 to page thirteen of our budget submission,
6 shows an interesting chart. Negative cash
7 flow is not at all unusual to a public pension
8 fund, but most funds are in the 2 to 3 percent
9 negative cash flow. Pennsylvania -- or PSERS
10 was in that 7 to 8 percent range that Jim
11 talked about.

12 But, as a result of Act 120, we've
13 gone from a position where -- we're the lower
14 line here -- we've actually crossed, so that
15 our projected negative cash flow is actually
16 in a better situation than most public pension
17 funds. And that's been a fairly recent
18 development. But we do pay particular
19 attention to it because of the consequences if
20 you don't.

21 SERS CIO LEWIS: And I would say, I
22 would say from a SERS perspective and how we
23 think about liquidity, it really helps shape
24 your views on asset allocation and how much
25 liquidity risk and volatility that you really

1 need to try to manage. And that's part of
2 the -- some of the stress testing that you've
3 heard others talks about here today, running
4 those scenario analysis, with multiple
5 assumptions on contributions or levels of
6 contributions coming in or not coming in
7 versus the amount of dollars that we need to
8 go out.

9 The other point I would make on that
10 is, when we think about -- we hear a lot about
11 the portfolio could be managed at a lot lower
12 expense ratio by just going to 60/40
13 portfolio. Not only does that increase the
14 volatility that we've seen here recently of
15 your returns, the fixed income component of a
16 60/40 portfolio has almost been one-to-one
17 correlated with equity markets over the last
18 generation of investing.

19 And so, what that means is, when
20 equities have gone down significantly, liquid
21 fixed income has gone down significantly as
22 well. We ran a test, and our expected returns
23 show, going forward, over the next ten years,
24 a 60/40 portfolio, having an expected return
25 of about 6 percent.

1 If we were only to yield 6 percent of
2 the portfolio or return versus a 7.25 target,
3 that would mean an additional 500 million
4 dollars annually coming from the employer to
5 make up the gap on the dollars that we need to
6 go out to our members.

7 So, liquidity is something that is
8 number one in top of mind as we think about
9 asset allocation and investment
10 diversification.

11 REPRESENTATIVE BOYLE: Thank you.
12 Those answers are reassuring.

13 Thank you.

14 MAJORITY CHAIRMAN SAYLOR:
15 Representative and chairman of the House State
16 Government Committee, Garth Everett.

17 REPRESENTATIVE EVERETT: Thank you,
18 Mr. Chairman.

19 I just want to quickly follow up,
20 make sure I got some information correct, and
21 maybe get the same information from PSERS.

22 So, the employee contributions were
23 394 million this year, and the employer
24 contributions were 2.2 billion.

25 SERS EXECUTIVE DIRECTOR SANCHEZ:

1 Yes. I'm sorry. That was SERS.

2 REPRESENTATIVE EVERETT: For SERS,
3 yeah. And SERS paid out 3.4 billion.

4 Correct?

5 SERS EXECUTIVE DIRECTOR SANCHEZ:

6 Correct.

7 REPRESENTATIVE EVERETT: And, Glen,
8 do you have similar figures for PSERS?

9 PSERS CIO GROSSMAN: Yeah. For the
10 fiscal year that ended June 30th, members
11 contributed to the pension plan a little over
12 a billion dollars and the employers
13 contributed in about 4.25 billion dollars.

14 REPRESENTATIVE EVERETT: And what was
15 the overall payout to --

16 PSERS CIO GROSSMAN: The benefits
17 were 6. -- about 6.6 billion.

18 REPRESENTATIVE EVERETT: The 4.25 of
19 the employer contributions, do you have a
20 breakdown of what was -- is there a breakdown
21 of what school district and what the state
22 pays in?

23 PSERS EXECUTIVE DIRECTOR GRELL: It's
24 roughly 50/50.

25 PSERS CIO GROSSMAN: It's roughly

1 50/50.

2 REPRESENTATIVE EVERETT: About 50/50.
3 Okay.

4 PSERS EXECUTIVE DIRECTOR GRELL:
5 Every school district gets at least 50
6 percent, depending on their aid ratios. Some
7 districts get more than 50 percent
8 reimbursement from the Commonwealth. That's
9 in the line item in PDE's budget, I believe.

10 REPRESENTATIVE EVERETT: In the PDE
11 budget. Yeah, okay. And each of our
12 districts -- where to find that, at least.

13 PSERS EXECUTIVE DIRECTOR GRELL:
14 Yeah. That represents the amount of
15 contribution -- or reimbursement from the
16 state to the school districts.

17 SERS EXECUTIVE DIRECTOR SANCHEZ: And
18 on the SERS side, the general fund, the amount
19 is about 40 percent. So, 40 percent of those
20 employer contributions, or the 2.2 billion, is
21 from the general fund.

22 REPRESENTATIVE EVERETT: And the
23 other portion is from --

24 SERS EXECUTIVE DIRECTOR SANCHEZ:
25 Special funds, like motor license vehicle

1 fund, federal funds coming in through, or some
2 independent employers like State System of
3 Higher Education, Penn State University.

4 REPRESENTATIVE EVERETT: Okay. Thank
5 you.

6 And I think that -- I think we heard
7 that both -- I mean, I know there's so many
8 variables -- but 2042 is the year that we can
9 look that we'd -- just as a number --

10 PSERS CIO GROSSMAN: That would be
11 assuming that we had -- all the variables are
12 met, yeah.

13 PSERS EXECUTIVE DIRECTOR GRELL: For
14 100 percent.

15 REPRESENTATIVE EVERETT: Right.

16 And I think I heard Director Sanchez
17 mention that 100 percent -- I mean, we may get
18 there some day. Is there -- in the pension
19 world, is there an absolute need to ever get
20 to exactly 100 percent? Is that something
21 that's open to debate?

22 SERS EXECUTIVE DIRECTOR SANCHEZ:
23 It's always the goal. Any actuary will tell
24 you it is always the goal to get to 100
25 percent. It's not easy or possible, and

1 sometimes we get there and we get past it and
2 decisions are made that takes us right back
3 down to where we are. But it is --

4 REPRESENTATIVE EVERETT: I think we
5 were there once when some decisions were made.

6 SERS EXECUTIVE DIRECTOR SANCHEZ:
7 Yes. We were way over. But it is always --
8 it is always, you know --

9 REPRESENTATIVE EVERETT: At least we
10 thought we were there.

11 SERS EXECUTIVE DIRECTOR SANCHEZ:
12 Right.

13 That's what all the funding policies
14 will work towards.

15 REPRESENTATIVE EVERETT: Okay. Yeah.
16 Thank you very much for answering all the
17 questions today and for being here with us. I
18 think we all learned a lot and really
19 appreciate it.

20 Thank you.

21 MAJORITY CHAIRMAN SAYLOR:
22 Representative Bradford.

23 REPRESENTATIVE BRADFORD: Thank you,
24 Chairman.

25 I want to thank both pension funds

1 for coming forward today.

2 I know that, in my ten years in the
3 legislature, the pension issue has taken up a
4 ton of time. And I know, Glen, you spent a
5 ton of time. I know Patty remembers those
6 conversations well. And I remember the three
7 buckets like it was yesterday and those
8 conversations. And I appreciated your
9 passion, and, frankly, your rightfully
10 conservative and concern about the road we
11 went down.

12 And I know Representative Everett
13 actually started to talk about kind of the
14 drive back to 100 percent. And,
15 unfortunately, in light of the mistakes that
16 were made for quite a prolonged period of
17 time, governors of both parties, legislatures
18 of both parties, full complicity of everyone
19 involved, really drove us into quite a mess.

20 And to see us here today talking
21 about, you know, a real level-headed
22 understanding of what it's going to take to
23 get back to 100 percent, I think that is where
24 we need to get to, and not ever move away from
25 making the ARC payment, the actuarially

1 required contribution.

2 I think this is the closest to
3 winning that we're going to have, in light of
4 the mess that was created. And telling school
5 districts that, you know, this is what it's
6 going to look like for the next two decades,
7 that we're going to make an employee
8 contribution rate of 34, 35 percent, that's
9 what digging out of this hole is going to look
10 like.

11 And I can't help but say this is
12 really -- this is progress, and progress,
13 because of that mistakes were made, are really
14 painful.

15 The one thing that keeps coming back,
16 though, in light of what Garth said, is, you
17 know, we're only one recession away from
18 making the kind of decisions which said, Look,
19 the school district's already going to be
20 making 34 percent employee contribution --
21 employer contribution rate, and state
22 funding's going to get tight again. That next
23 recession will almost certainly say that
24 budget will get tighter here, and legislators
25 are going to say, you know, We don't have to

1 make the full ARC payment. We could do
2 something less than 100 percent of ARC. And
3 we're paying a hell of a price already, and
4 our schools are getting shortchanged as a
5 consequence.

6 And I just fear that when that next
7 recession comes that we're going to forget,
8 that, right now, when it's somewhat sunny
9 outside, politically or fiscally, that we will
10 be tempted to go down that road. I just think
11 it is so important that we realize the
12 horrible price we're paying for it, our school
13 districts are paying for it and that we never
14 get away from the ARC.

15 So, my question actually is this. We
16 have given some language to, I think, both
17 funds about a constitutional amendment that
18 would require us to make the ARC, the full
19 ARC, and never go down that road again of,
20 frankly, borrowing from the pension funds to
21 pay for current needs in Harrisburg, realizing
22 we pay a de facto 7 and a half percent
23 interest rate from any loan from these pension
24 funds, and knowing that next recession is
25 maybe only several years away.

1 What do you think about a
2 constitutionally required ARC payment that
3 will prevent this kind of foolhardy, you know,
4 "live for the day and forget about the
5 consequences of tomorrow" approach?

6 PSERS EXECUTIVE DIRECTOR GRELL: Two
7 points on your observations.

8 First of all, the -- the rate picture
9 is not quite as bleak as you painted it. It's
10 not going to be a 34 percent employer rate
11 until 2042. Just as you're in the closing
12 years of your mortgage more of your payment
13 goes toward principal and less toward
14 interest, the rate will come back down.

15 Secondly, if those -- if that
16 scenario plays out that you're concerned about
17 the next recession and tight money, be assured
18 that, if we're here, we will be over to remind
19 you, in vigorous language, what the
20 consequence of that might be.

21 In terms of constitutional amendment,
22 it was one of the ideas that we included in
23 our testimony before the commission as
24 something that the commission ought to look at
25 and consider making a recommendation. You

1 know the challenges of doing any
2 constitutional amendment, the time that's
3 involved and the way the question is worded,
4 and all those things I defer to your judgment
5 on that. But there are some states where
6 there is a constitutional requirement to pay
7 the ADC or the ARC, and typically, in those
8 states, they are not in the same kind of
9 condition that we're in.

10 So, it would certainly address what
11 we see as our highest priority is to make sure
12 that every year we get that ADC.

13 SERS EXECUTIVE DIRECTOR SANCHEZ:
14 Same thing here. In our testimony before the
15 commission, it was our number one ask, our
16 biggest ask was that it be considered.

17 REPRESENTATIVE BRADFORD: Thank you.
18 Thank you, Chairman.

19 MAJORITY CHAIRMAN SAYLOR: Just a
20 little bit to follow up on my colleague's
21 comments. I think that, you know, one of the
22 things that hopefully, as you look at this
23 commission's report and your boards take a
24 look at that, whatever things that you see as
25 improvements and working with you here in the

1 general assembly, are going to be positive
2 things.

3 Hopefully we also, as we move forward
4 into performance-based budgeting, we'll not be
5 cutting necessarily your funding but rather
6 making our own programs that we have funded
7 here better. And -- which will hopefully give
8 us some savings that maybe we can invest in
9 the pension system as well.

10 So, with that, I want to thank all of
11 you for coming today. I appreciate your time.

12 And, with that, we're adjourned until
13 tomorrow at 10:00 a.m., when we will have the
14 new budget secretary, Jennifer Swails, before
15 us.

16 (Whereupon, the hearing concluded at
17 3:44 p.m.)

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