

PENNSYLVANIA STATE EMPLOYEES' RETIREMENT SYSTEM
SUMMARY OF LEGISLATION FOR THE
SUBCOMMITTEE ON PUBLIC PENSIONS, BENEFITS AND RISK MANAGEMENT

THURSDAY, JANUARY 20, 2022

House Bill 811 – Retirement System Reform – Susquehanna River Basin Commission

House Bill 811 was introduced by Rep. Jim Cox (R, Berks) on June 11, 2021. Previously, this bill was introduced during the 2019-2021 legislative session as House Bill 60, which passed in the House but saw no action in the Senate.

House Bill 811 would close SERS membership to all future employees of the Susquehanna River Basin Commission (SRBC) and remove any reference to the Interstate Commission of the Delaware River Basin (ICDRB) from the definition of "state employee" in the Retirement Code. The ICDRB was established in 1936 and employees were allowed to become SERS member in 1947. In 1963, its functions were transferred to the Delaware River Basin Commission, and only those employees of ICDRB with at least 10 years of service prior to January 1, 1963 were allowed to remain in SERS.

There are no longer any active or living retired members of the ICDRB in SERS, so this change is essentially a housekeeping measure that cleans up the code. Furthermore, there were no subsequent provisions for employees of the Delaware River Basin Commission to become members of SERS.

Currently, there are 62 active members of SERS at the SRBC.

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House Bill 967 – Substitute Teacher Shortage

House Bill 967 is legislation that focuses on PSERS, and has no impact on SERS.

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House Bill 1442 – Limiting Government "Pension Hopping"

House Bill 1442, introduced by Rep. DeLuca (D, Allegheny), on May 17, 2021, would limit a public official/public employee who is eligible to receive benefits from more than one pension system to elect to receive benefits from only one of those systems. If an election isn't made, the public official or employee will receive a pension from the system that would provide the highest benefit. The bill states that the limitation does not apply to a beneficiary who is eligible to receive benefits from more than one pension system. The act would apply to a public official/public employee who becomes eligible to receive benefits from more than one pension system on or after the effective date of the bill.

In response to an IFO request for cost estimates, SERS provided a detailed analysis of the bill, which would limit a public official/public employee who is eligible to receive benefits from more than one pension system to elect to receive benefits from only one of those systems. The analysis identified a number of technical problems that made it impossible to calculate potential costs, based on the limited information and parameters prescribed in the bill. On August 26, 2021, this analysis was provided to both the IFO and Rep. Seth Grove, Chairman of the House State Government Committee. That analysis is included herein.

To: Rep. Seth Grove, Chairman, House State Government Committee
Mathieu Taylor, Fiscal Analyst, Independent Fiscal Office

From: Thomas Derr, Director of Communications and Policy
State Employees' Retirement System

Date: August 26, 2021

Re: **H.B. 1442, P.N. 1556**
Design issues that interfere with SERS cost analysis

Dear Chairman Grove / Mathieu,

On August 18, the Independent Fiscal Office asked SERS for an actuarial analysis of H.B. 1442, P.N. 1556, to aid the IFO in preparing a cost analysis of the bill by identifying features with potential cost implications.

For a variety of reasons, as noted below, that it is a difficult assignment to do – especially in a short time-frame. SERS would need to make major assumptions about the eventual form and operation of the legislation on which to base its cost analysis, or work with the Bill Sponsor for guidance on his intended operation of the bill and possible amendments before SERS can provide actuarial costs that reflect the goals of the Sponsor.

Even after such direction is given, assimilating the required data from the more than 3,000 local government pension plans in the Commonwealth to identify the number of persons to whom the legislation might apply, the patterns of behavior, and which benefits might be higher (all which would factor into the costs), would be both time-consuming and difficult at best for SERS and the local plans. Data gathering and analysis tools would need to be developed to manage this volume of data. In addition, there may be technical and/or legal reasons that prohibit local plans from sharing the necessary data and information with us. Only after the gathering and assimilation of data is complete, could a somewhat meaningful actuarial analysis be done.

H.B. 1442 attempts to limit most public employees to receiving just one pension funded in full or in part by a public employer. This legislation would cover not just SERS, PSERS and PMRS, but also the vast majority, if not all, of Pennsylvania's political subdivisions' local pension plans ("local plans"). The legislation is drafted as a stand-alone law. It does not directly amend the underlying enabling legislation of the SERC or other Pennsylvania public pension plans.

Most of the bill is comprised of definitions. The operational language of the bill is succinct:

Section 3. One pension allowable.

(a) Entitlement. – Notwithstanding any other provision of law, a public official or public employee eligible to receive benefits under more than one pension system shall only be entitled to receive benefits under one of the pension systems.

(b) Election. - A public official or public employee subject to subsection (a) may elect to receive benefits under one of the pension systems. If the public official or public employee makes no such election, the public official or public employee shall receive benefits through the pension system that provides the highest amount of benefits.

(Page 3, line 23 - Page 4, line 3)

Note: To reiterate, this memorandum addresses only the cost-related issues that we were asked to comment on. It does not address additional aspects and issues that may be of key concern:

- a. Most of the public policy issues and consequences surrounding the bill;
- b. Technical aspects of the bill, such as the probable need to make conforming amendments to the State Employees' Retirement Code or adding language in H.B. 1442 that expressly override the current SERC, especially in the areas of membership and benefit eligibility;
- c. Issues and actuarial costs unique to PSERS, PMRS, or other local plans; and
- d. Administrative costs and relatively minor design issues that may impact actuarial cost.

It is our understanding that PSERS and PMRS may be providing information regarding some of the above issues. For the purposes of the IFO assignment, SERS has focused on cost-related matters, but we also recognize that the proposed legislation carries substantive practical and policy-related, operational and administrative challenges that may be important to explore. Please let us know if you would like to discuss these concerns as well.

Following is a summary of major design issues that, if clarified or confirmed, would assist SERS in preparing a cost analysis that matches the intentions of the Sponsor.

1. H.B. 1442 is not clear on what type of pension and retirement plan arrangements fall into the bill's definition of "pension system." SERS' IRC §401(a) defined benefit plan clearly does. Conversely, the Commonwealth's IRC §457 deferred compensation plan clearly does not, because there are no employer contributions to that plan. It is not clear whether the State Employees' Defined Contribution Plan and the School Employees' Defined Contribution Plan, both of which are IRC §401(a) defined contribution plans, or the IRC § 403(b) plans operated by school districts, or any of other non-IRC § 401(a) DB plans that may be operated by local employers are included in the scope of the bill. Without knowing exactly which plans could disqualify State employees from receiving SERS benefits, it is difficult to cost the impact of H.B. 1442.¹
2. Similarly, H.B. 1442 seems to eliminate "multiple service" between SERS and PSERS that allows a combined SERS/PSERS benefit. Multiple service has existed since 1959. Multiple service is legislative recognition that DB plan design optimizes the pension benefits for a full career of service with the covered employers, and that the "whole is greater than the sum of the parts" in most DB system benefit formulas.

¹ The SEDCP receives employer contributions. A significant design feature of DC plans is that their assets are portable. DC plans allow employees to move their vested DC plan funds (without regard to their source) to the plan of their next employer. Portability enables an employee to accumulate retirement assets and benefits over the employee's entire career with the goal of having sufficient retirement funds at retirement age. Including DC plans in the prohibitions of H.B. 1442 would defeat a major policy goal of DC plans.

3. H.B. 1442 does not distinguish between the different types of annuities in SERS or other pension plans. All benefits of any type from any covered pension system could impact SERS benefit eligibility. A small early retirement benefit based on a short period of public service can have the same disqualifying impact as a superannuation annuity at full retirement age after a long career. Similarly, a temporary disability annuity that is terminated when the underlying medical condition abates has a full disqualifying impact.
4. The bill is also silent on important mechanics that will need to be developed, the ultimate resolution of which will have significant actuarial cost impacts:
 - a. Because of the “highest amount” language in § 3(b), it probably can be assumed that public employees will be enrolled as members in the second public pension plan and that both the employees and their employers will make the required contributions to the second plan. This seems to be the logical approach because if the second public employment position ultimately produces the larger benefit, then it needs to be funded by employee and employer contributions.
 - b. Question: If the employees are enrolled in a second (or more) plan, but ultimately the second period of public employment does not result in the larger benefit, then what happens? Presumably, the employee will receive a refund of the employee’s contributions with interest. It also might be necessary to increase the interest rate to avoid substantive due process issues. The IRC does not allow the “forfeited” employer contributions to be refunded to the employer. Another aspect: Could this, then, become a situation wherein employee contributions are being held for a benefit that cannot be paid?
 - c. Question: If an employee who enrolls in a second plan is receiving an annuity from a prior plan, then what happens to that annuity? Does it continue during the second employment and cease at the time of the second termination only if the second employer’s pension benefit is larger? If so, does the first pension plan recoup any payments? If annuity payments stop when the second employment begins, then do they accumulate and are paid after the second termination if the second employer’s benefit is not larger? There are significant legal, federal tax, and possibly constitutional issues involved in determining what happens to the first annuity stream. This memo is not the place to analyze them. However, for SERS to perform an actuarial cost impact, SERS needs to know how the benefits it is paying will be handled when a SERS annuitant begins employment with a second public employer.

In addition to the design questions for which SERS needs guidance in order to provide meaningful cost estimates, there are several other features of the bill that raise costing issues – even though the bill language is not as ambiguous. Clarification of intent on these topics could make the cost analysis more accurate.

5. **Beneficiaries:** H.B. 1442 provides that payments to beneficiaries of other public employees’ benefits are not impacted and are not disqualifying payments. As such, the H.B. 1442 definition of “beneficiary” could be interpreted as a general term that covers both lump sum and survivor annuity payments from all systems. This definition, however, is written narrowly enough that it does not cover beneficiaries who are designated by operation of law –it covers only “a person last designated in writing to a pension system” Page 1, lines 12-13. Additionally, the beneficiary exception does not cover SERS members who are alternate payees receiving equitable distribution or support payments because of a domestic relations order from a living annuitant and not as a death benefit.

- 6. Tracking:** By working with PSERS and PMRS, SERS may be able to develop an estimate of how many current active members are eligible for a benefit or have PSERS or PMRS service and how many SERS members are now PSERS or PMRS members. However, we do not know how many active members are receiving or are eligible for the 2,000+ other local government plan benefits that are not part of PMRS or whether the projected value of those benefits are greater than the projected value of their SERS benefit.

Furthermore, we do not know how many SERS members later gain employment with political subdivisions and earn a second pension. We also have no real idea of the relative sizes of the SERS benefits and municipal benefits, to determine if it is SERS benefits that would be impacted, or those of one of the 3000+ local government plans. The bill provides no guidance and does not have any reporting mechanisms to inform SERS if we are enrolling members eligible for other public pensions or if our annuitants are hired by other public employers.

- 7. State Police:** State police do not participate in Social Security. Federal law allows this only if they are eligible for an adequate level of retirement benefits from the Commonwealth for that service. H.B. 1442 does not recognize this factor. Therefore, while SERS can cost H.B. 1442 as written regarding State police, it is likely that the eventual form of H.B. 1442 would need to exempt State police from its coverage to accommodate the federal requirements.
- 8. Retiree Health Care:** An additional aspect that could be easily overlooked coincides with annuity payments: In many circumstances – including at SERS – members qualify for retiree health care benefits independent of their annuity, with the stipulation that they must be receiving their annuity in order to receive retiree health care coverage. It is a very real concern that by terminating a benefit, retiring employees could end up losing their retiree health care as well.
- 9. Timing:** The bill becomes effective 60 days after enactment. SERS needs to select an effective date to cost the bill. A logical date to use for this exercise is January 1, 2022. That date is the start of our plan year and actuarial valuation year and assumes an enactment date of November 2.

A more significant “effective date” issue is that H.B. 1442 could result in an unconstitutional impairment of contract to some State employees. The bill would apply to a public official or public employee “who becomes eligible to receive benefits under more than one pension system on or after the effective date of this act.” Page 4, lines 8-11. As written, this includes State employees who are accruing benefits in SERS but who are not yet vested. It is a reasonable reading of Pennsylvania case law that applying H.B. 1442 to eliminate benefits accrued and currently being earned by State employees is a colorable unconstitutional impairment of contract.

SERS welcomes your interest in discussing the issues and aspects relating to H.B. 1442, P.N. 1556, as outlined above.

Our goal, as always, is to provide the legislature and the IFO with information and data that is as clear and accurate as possible in order to facilitate your work in crafting legislation and analysis that best serve the interests of SERS’ members and participants, and the citizens of the Commonwealth.

We look forward to our forthcoming discussion.

Thank you again for your time and consideration.

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House Bill 1578 – Pension Reform Legislation Eliminating Collar Provisions

House Bill 1578, introduced by Rep. Keefer (R, York) on June 8, 2021, would eliminate the collar contributions for SERS and PSERS. This bill was also introduced during the 2019-2021 legislative session as House Bill 1963, which passed in the House but saw no action in the Senate.

SERS views this essentially as a housekeeping piece of legislation designed to officially recognize that Act 120 collars are no longer in effect. As such, SERS has no issues with it. At the same time, SERS accepts and appreciates the underlying intent of the legislation, which is to reaffirm the importance of fully funding the system by continuing to pay the Actuarially Determined Contribution.

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House Bill 1671 – Pension Fund Fee Transparency Legislation

House Bill 1671, introduced by Rep. Brett Miller (R, Lancaster) would add additional investment transparency and reporting requirements for SERS and PSERS. The legislation is similar to House Bill 1964, introduced during the prior session. The bill received second consideration before the sine die end of the session in 2020.

Overview: SERS' primary concern with the previous HB 1964 was addressed with an amendment sponsored by Rep. Matt Bradford, which removed a stipulation that SERS disclose particularly sensitive confidential items such as unredacted marketing materials, side letters, etc. Subsequently, SERS leadership engaged in several conversations with the prime sponsor and his staff, regarding issues relating to the divulging of information heretofore considered confidential and protected by the Right To Know Law (RTKL), or disclosing retroactive and sensitive historical information (which may be contrary to existing contract terms, and/or to which SERS may not have access).

The current version of the legislation largely addresses SERS' concerns regarding RTKL protections and makes the reporting requirements for certain key metrics prospective in nature, applying to new contracts and agreements entered into after the effective date. The bill also establishes requirements for PSERS and SERS regarding livestreaming and posting of video and records – something that SERS is already doing.

The bottom line is that we believe SERS will be able to work within the guidelines of the legislation as it currently stands.

Costs: Over the past year and more, SERS has worked steadily towards improved transparency, which includes live streaming and publishing information from public committee and board meetings on the SERS website. Costs incurred to date amount to approximately \$125,000. Our annual costs for maintenance, licensing, and closed captioning related to this endeavor are expected to be approximately \$20,000.

SERS has implemented or has plans to implement the investment reporting noted in the bill. Currently, SERS is evaluating software to help account, track, and report investment manager fees, expenses, and carried interest. Software costs are expected to be \$500,000 annually, with additional one-time implementation costs expected to be \$200,000. It is important to note that because the SERS Board is already moving in the direction proposed by the legislation, SERS staff would be spending time on the requirements in the legislation and the above costs would be incurred regardless of whether or not the legislation is enacted.

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House Bill 1698 – PSERS/SERS Global Investment Performance Standards (GIPS)

House Bill 1698, introduced by Rep. Frank Ryan (R, Lebanon) on June 24, 2021, would require SERS and PSERS to comply with requirements contained in the 2020 edition of the Global Investment Professional Standards (GIPS), as promulgated by the CFA Institute, beginning with Fiscal Year 2022-23. Both systems would document compliance with the standards, create an annual GIPS Asset Owner Report, and retain a firm to conduct independent performance verification. The legislation also includes provisions that allow the boards to adopt updates to the standards at a public meeting.

The legislation seeks to provide an enhanced level of comfort and integrity in investment performance calculation and reporting. As such, it appears to be in line with SERS’ position on transparency and our existing performance standards.

Costs (as provided to the IFO, August 31, 2021):

Type of Cost	Implementation Costs	Annual Costs
Internal Costs		
Two dedicated professional staff to: 1) ensure SERS annual compliance with GIPS; 2) document/monitor policies, procedures, and systems, needed and 3) oversee the compilation and external review of the annual GIPS Asset Owner Report for the Defined Benefit (DB) and Defined Contribution (DC) Plans.		\$ 267,750
External Costs		
Consultant to evaluate current state of SERS and assist with implementation plan towards GIPS compliance for DB and DC plans, including documentation of policies and procedures, training of staff, etc.	\$ 225,000	
Firm to conduct independent performance verification and examination of SERS GIPS Asset Owner Reports for DB and DC (<i>NOTE - this does not include a full recalculation of SERS performance</i>).		\$ 150,000
Total Estimated Costs	\$ 225,000	\$ 417,750

It is important to note that any costs incurred for the DC plan (approx. \$37,500 implementation and \$25,000 annually) will be directly charged to employers through the annual per-participant employer assessment. SERS produced these estimates based on our interpretation of the legislation and best information available at the time of preparation. Actual costs incurred may differ from the estimates provided.

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House Bill 2010 – Fiduciary Training for Public Pension Fund and State Fund Fiduciaries

House Bill 2010, introduced by Rep. Frank Ryan (R, Lebanon) on October 26, 2021, which adds training requirements for fiduciary law for board members.

Historically, SERS has been supportive of efforts to improve fiduciary education for board members and staff. It is leadership's view that such efforts can only enhance their ability to represent the interests of the system's members and participants.

From a cost standpoint, SERS would not anticipate a significant impact as a result of the legislation.

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House Resolution 59 – Early Retirement Study

House Resolution 59, introduced by Rep. Robert Merski, (D, Erie), on February 24, 2021, directs the Legislative Budget and Finance Committee to conduct a cost analysis study of an early retirement proposal for members of SERS and PSERS who are 55 years of age or older or who have at least 30 years of service.

SERS notes that the last piece of legislation involving the establishment of an Early Retirement window for which SERS was asked to provide a cost analysis was HB 31, which was introduced more than a decade ago, in 2009. Obviously, much has changed since then, in terms of SERS' financial status, changes in member benefits, and in the demographics of our members and participants. In addition, there were a variety of technical problems with the bill that made it difficult to clearly determine its full implications.

At that time, our actuaries estimated that, depending upon how many people availed themselves of the early retirement window, the unfunded liability cost to SERS would range from \$72 million to \$308 million. That cost would be amortized over 10 years through higher employer contributions (which would be on top of the already projected increases in contributions). Because the liability is being paid off over time, there is a financing cost such that the total amortization payments are considerably more than the initial unfunded liability (similar to taking out a loan to buy a car, where the total payments will be considerably more than the original sale price negotiated with the dealer).

SERS' position on the legislation is neutral. But we are willing to work with the bill's sponsor to identify and mitigate any potential problems that could impact the ability of our actuaries to provide a reasonable estimate of the potential costs involved in developing this proposed early retirement study.

While the number of impacted members fluctuates as employees pass through the age and service thresholds, SERS estimates that the current number of impacted members is approximately 1,500.

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SB 423 – Allowing Return to Service Part-Time Fire Instructors

SB 423, introduced by Sen. Judy Ward (R, Blair), on March 15, 2021, amends Sections 5301, "Return to service" and Section 5706, "Termination of annuities" of Title 71 (State Government) to allow SERS annuitants to serve as part-time fire instructors without losing their pension benefits. The measure would prevent members returning to state service from joining another retirement system for which they'd be eligible to join based on their employment. In addition, service as a part-time instructor would not add to an individual's current pension.

Part-time fire instruction must be at:

- The Pennsylvania State Fire Academy
- The Department of Education
- A State-owned educational institution
- A community college
- Penn State University

The legislation further stipulates that every instructor must have received certification as a firefighter training instructor from the Pennsylvania State Fire Academy.

SERS has estimated that there are five or fewer individuals that could be impacted by this legislation. Therefore, the cost impact likely would be de minimis.

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