PUBLIC EMPLOYEE RETIREMENT COMMISSION

2008 ANNUAL REPORT

Commonwealth of Pennsylvania

2008

Annual Report

of the

Public Employee Retirement Commission

Public Employee Retirement Commission
Commonwealth of Pennsylvania
February 2009

PUBLIC EMPLOYEE RETIREMENT COMMISSION

Gubernatorial Appointees

Mr. A. Carville Foster, Jr.,
Chairman
Retired Legislator

Mr. Christ J. Zervanos
Vice Chairman
Retired Director of Labor Relations
Office of Administration
Commonwealth of Pennsylvania

Dr. J. Richard Aronson
William L. Clayton Professor of Business & Economics
Lehigh University

Mr. Anthony W. Salomone
Retired Executive Director
Public Employee Retirement Commission
Commonwealth of Pennsylvania

Mr. David F. Werner, CPA
Partner Multistate Tax Services
Beard Miller Company LLP

Legislative Appointees

Senator Patrick M. Browne
District 16
Lehigh, Monroe & Northampton Counties

Senator Jay Costa, Jr.
District 43
Allegheny County

Representative R. Ted Harhai
District 58
Fayette & Westmoreland Counties

Republican House Member Appointee
Vacant

Executive Director: James L. McAneny

Commission Office: 510 Finance Building
P. O. Box 1429
Harrisburg, PA 17105-1429

Telephone: (717) 783-6100
FAX: (717) 787-9531
E-mail: perc@state.pa.us
Web Site: www.perc.state.pa.us

COMMONWEALTH OF PENNSYLVANIA
PUBLIC EMPLOYEE RETIREMENT COMMISSION
HARRISBURG
17120

February 2009

To: Governor Rendell
and Members of the Pennsylvania General Assembly

As required by the Public Employee Retirement Commission Act, this annual public report is issued to summarize the Commission's findings, recommendations, and activities for the year 2008.

During 2008, the Commission authorized the attachment of thirteen actuarial notes to bills and amendments at the request of the various committees of the General Assembly. This report contains a synopsis of each of these notes and contains a summary of the Commission's review of the Public School Employees' Retirement System and the State Employees' Retirement System. This report also describes research conducted during 2008 and summarizes the Commission's administrative activities under the Municipal Pension Plan Funding Standard and Recovery Act and Act 293 of 1972.

On behalf of the Public Employee Retirement Commission and its staff, I am pleased to submit the twenty-sixth annual public report of the Commission. The Commission hereby expresses its thanks and appreciation to all individuals, organizations, and agencies whose assistance and cooperation contributed to the work of the Commission during 2008.

Sincerely,

A. Carville Foster, Jr.
Chairman

Dedication

The members of the Public Employee Retirement Commission and its staff dedicate this twenty-sixth annual public report to

PAUL D. HALLIWELL

Mr. Halliwell was appointed as a charter member of the Public Employee Retirement Commission on October 27, 1981, was elected and served as Chairman of the Commission from April 18, 1995, until March 20, 2008, and served faithfully and conscientiously in those capacities until the end of his appointment on June 26, 2008.

During Mr. Halliwell's long tenure, the Commission developed and implemented the Municipal Pension Plan Funding Standard and Recovery Act, which resulted in major reforms to Pennsylvania's local government pension systems, issued more than 500 actuarial notes on proposed public employee pension legislation, and issued numerous policy development reports to the Governor and the General Assembly.

The Public Employee Retirement Commission expresses its sincere appreciation to Mr. Halliwell for his technical expertise on public pension issues, his ability to understand, integrate, and lead, and for his professional dedication and commitment to the Commission, its staff, and the citizens of the Commonwealth, and wishes him the best of health, happiness, and success in his future endeavors.

Introduction

The Public Employee Retirement Commission was created in 1981 by the Public Employee Retirement Commission Act. The Commission is composed of nine members, five of whom are appointed by the Governor with the advice and consent of the Senate and four of whom are appointed by the leaders of the General Assembly.

Under the Public Employee Retirement Commission Act, the Commission has two main responsibilities. One is to issue the required actuarial notes for proposed legislation affecting public employee retirement systems. The other is to study, on a continuing basis, public employee retirement system policy and the interrelationships, actuarial soundness and costs of the retirement systems.

Under the Municipal Pension Plan Funding Standard and Recovery Act, adopted in 1984, the Commission has two additional responsibilities. The first is to administer the actuarial valuation reporting program for municipal retirement systems, which entails monitoring and enforcing compliance with the statutorily mandated actuarial funding standard. The second is to certify annually municipal pension cost data used in allocating General Municipal Pension System State Aid, which exceeded $206 million in 2008.

One of the other responsibilities of the Commission under the Public Employee Retirement Commission Act is to issue an annual report to the Governor and the General Assembly. The first three reports were issued on a fiscal year basis. This is the twenty-third report issued on a calendar year basis.

The Commission thanks those who actively participated in its meetings, the members of its advisory committees and the organizations they represent, and all others who have offered advice and support to the Commission during 2008.

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont'd)

TABLE OF CONTENTS (Cont'd)

Page

DUTIES AND RESPONSIBILITIES

OF THE COMMISSION

PART I

PREPARATION OF ACTUARIAL NOTES AND ADVISORY NOTES

A. STATUTORY PROVISIONS.

The Public Employee Retirement Commission Act provides, in pertinent part:

Section 6. Powers and duties.

(a) In general - The commission shall have the following powers and duties:

(13) To issue actuarial notes pursuant to section 7.

Section 7. Actuarial notes.

(a) Note required for bills. - Except as otherwise provided in subsection (f)(1), no bill proposing any change relative to a public employee pension or retirement plan shall be given second consideration in either House of the General Assembly, until the commission has attached an actuarial note prepared by an enrolled pension actuary which shall include a reliable estimate of the cost and actuarial effect of the proposed change in any such pension or retirement system.

(b) Note required for amendments. - Except as otherwise provided in subsection (f)(2), no amendment to any bill concerning any public employee pension or retirement plan shall be considered by either House of the General Assembly until an actuarial note prepared by an enrolled pension actuary has been attached.

(c) Preparation of note. - The commission shall select an enrolled pension actuary to prepare an actuarial note which shall include a reliable estimate of the financial and actuarial effect of the proposed change in any such pension or retirement system.

(d) Contents of a note. - The actuarial note shall be factual, and shall, if possible, provide a reliable estimate of both the immediate cost and effect of the bill and, if determinable or reasonably foreseeable, the long-range actuarial cost and effect of the measure.

(e) Notes for proposed constitutional amendments. - The commission shall issue an actuarial note, prepared by an enrolled pension actuary, for any joint resolution proposing an amendment to the Constitution of Pennsylvania which initially passes either House of the General Assembly. If said joint resolution is subsequently amended and passes either House of the General Assembly, a new actuarial note shall be prepared.

A. STATUTORY PROVISIONS. (Cont'd)

The requirement that an actuarial note be attached to public employee pension and retirement bills prior to their second consideration in either house of the General Assembly was a modification of the legislative process. In response to this statutory mandate to prepare the required actuarial notes, the Commission and the leaders of the General Assembly developed and implemented legislative procedures. The standardization of these procedures makes it easier to expeditiously and efficiently provide the required actuarial information to the General Assembly. The procedures clarify the manner of attaching actuarial notes to bills, including floor amended bills and bills in the possession of the House and Senate Appropriations Committees upon the request of the chairman. The procedures also clarify the availability of the Commission's staff to provide technical assistance to members of the General Assembly on matters relating to public employee retirement system design, financing, and administration. The legislative procedures also provide for the preparation of advisory notes for committee chairmen. The Commission uses an advisory note, as distinct from an actuarial note, for the analysis of proposed legislation when the bill is being considered by a committee of the General Assembly. The advisory note is prepared primarily by the Commission's staff with review or additional analysis by one of the Commission's consulting actuaries as deemed necessary.

The legislative procedures are included in this report as Appendix B.

B. SUMMARY OF 2008 ACTIVITY.

During 2008, the Commission authorized the attachment of thirteen actuarial notes to bills and amendments at the request of the General Assembly. In addition, the Commission's staff provided the General Assembly with one advisory note.

C. SYNOPSES OF ADVISORY NOTES.

- House Bill Number 2084, Printer's Number 2940. At the request of Representative Jaret Gibbons, House State Government Committee, on April 2, 2008, the Commission staff provided an advisory note on House Bill Number 2084, Printer's Number 2940, which would amend the Public School Employees' Retirement Code and the State Employees' Retirement Code to provide an ad hoc postretirement cost-of-living adjustment (COLA) to eligible annuitants of both systems. The percentage increases are dependent upon an eligible annuitant's most recent date of retirement. Payment of the COLA would be made in equal annual installments of 20% of the COLA amount over a five-year period based upon and commencing with the first monthly annuity payment after July 1, 2007. Annuitants whose credited service includes Class T-D, AA or D-4 membership or whose most recent date of retirement is later than July 1, 2001, are ineligible to receive the COLA.

D. SYNOPSES OF ACTUARIAL NOTES.

A synopsis of each actuarial note containing a summary of each bill, its actuarial costs, and the disposition follows. These synopses are arranged by Senate and House Bill in numerical order. A subject index to the actuarial notes is provided in Appendix E.

Bill ID: Senate Bill Number 282, Printer's Number 319

System: City of Pittsburgh Firemen's Relief and Pension Fund

Subject: Continuation of Surviving Spouse's Benefit Regardless of Remarriage

SYNOPSIS

The bill would amend the act of May 25, 1933, (P. L. 1050, No. 242), known as the Second Class City Firemen Relief Law by removing the current requirement in the Law that the pension payments to a surviving spouse of a firefighter cease upon remarriage.

DISCUSSION

The Second Class City Firemen Relief Law (Law) is one of the statutes governing pension plans operated by the City of Pittsburgh. The statute provides for the establishment and operation of a defined benefit pension plan for uniformed employees of the City of Pittsburgh Bureau of Fire.

As of January 1, 2005, there were 737 active members of the plan, and 1,029 retired members and survivors receiving benefits. This number includes 359 surviving spouses and one surviving child receiving benefits. The current survivor benefit provisions of the law are summarized below.

Service-Related Death. Under the Law (Section 9), if a member dies as a result of injuries received in the performance of the member's duties; and

1) is survived by a spouse, the surviving spouse shall receive a survivor spouse pension of 50 percent of the officer's salary at the time of the officer's death that continues for 500 weeks or until the surviving spouse remarries or dies, whichever first occurs (less any Worker's Compensation benefits); or

2) if there is no surviving spouse, or the survivor spouse pension is terminated due to the expiration of 500 weeks or the remarriage or death of the surviving spouse, and there is one or more surviving child, each surviving child shall receive a survivor child pension of 25 percent of the member's pension until the child reaches age 18, marries, or dies, whichever first occurs, or if the surviving child is a dependent, incompetent individual, the survivor child pension may be paid indefinitely (total payments to one family may not exceed 50% of member's wages at time of death); or

3) If no spouse or unmarried eligible children survive, the survivor benefit passes to the deceased member's surviving dependent parents.

Death Prior to Retirement (Not Service-Related). Under the Law (Section 9.3), if a survivor benefit was elected by the member:

1) a survivor spouse receives a benefit equal to 50% of the pension benefit the member would have received if the member had been retired on the date of death, provided the member was married to the survivor spouse for at least two years prior to the death of the member and that the survivor spouse was dependent upon the member; or

2) If no survivor election was made, a refund of the member's accumulated contributions, without interest, is paid to the survivor(s) or to the estate.

Death of Retiree. Under the Law (Section 9.2), if a retired member dies; and

1) a survivor benefit was elected by the member, the surviving spouse receives a survivor spouse pension of 50 percent of the retired officer's pension that continues for life unless the surviving spouse remarries, provided the member was married to the survivor spouse for at least two years prior to the death of the member and that the survivor spouse was dependent upon the retired member; or

2) if there is no surviving spouse or the survivor spouse pension is terminated due to remarriage or death and there is a surviving child, the surviving child may receive a survivor child pension or if there are no surviving children, the benefit may be paid to the dependent parents of the deceased retired member.

Because survivor beneficiaries are generally made aware of the benefit cessation provisions of the plan, in practice, the instances in which benefits to survivors (spouses or children) are terminated because of remarriage are quite rare. The bill would amend the Law by removing current provisions requiring that the pension payments to a surviving spouse of a firefighter cease upon remarriage.

Statutory provisions requiring the termination of survivor spouse benefits upon remarriage were once a common feature of municipal pension plans and are based upon an orientation toward survivor benefits that is no longer deemed to be appropriate. Similar provisions were previously applicable to police officers employed by the City of Pittsburgh, firefighters and police officers under The Third Class City Code, and police officers in boroughs, incorporated towns, townships, and regional police departments under the Municipal Police Pension Law, but these provisions have since been repealed. Under the pension plans for nonuniformed employees of the City of Scranton and the standard pension plans administered by the Pennsylvania Municipal Retirement System, at the time of retirement, a municipal employee may elect to receive a single life annuity or, if the retiring employee wishes to provide financial assistance for dependents who may outlive the retiree, an employee may choose from one of several benefit options designed to provide survivor benefits for one or more designated beneficiaries. In neither system do any of the survivor options available to members terminate the retirement benefits to a surviving spouse upon remarriage.

SUMMARY OF ACTUARIAL COST IMPACT

The consulting actuary of the City of Pittsburgh has informed the Commission staff that the probability of remarriage for surviving spouses of deceased firefighters is not valued by the actuary in preparing the actuarial valuations of the pension system. Accordingly, there will be no change in the funding requirements of the plan upon enactment of the bill. Likewise, the consulting actuary of the Commission has reviewed the bill and determined that there will be no significant actuarial cost impact upon the City of Pittsburgh Firemen's Relief and Pension Fund resulting from passage of the bill.

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations:

> <u>Removal of Outdated Provisions</u>. The bill removes provisions in the Second Class City Firemen Relief Law that are based upon an orientation toward survivor benefits that is no longer appropriate.
>
> <u>Outdated Provisions Retained</u>. The bill does not remove provisions in the Law that require the surviving spouse to have been married to the member for at least two years prior to the member's death in order to be eligible for a survivor spouse benefit nor does it remove provisions in the Law that require the surviving spouse to have been "dependent" upon the deceased member in order to receive survivor benefits. If the removal of outdated survivor provisions is viewed as desirable, these additional provisions also should be removed.

COMMISSION RECOMMENDATION

On March 20, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

Senate Bill Number 282, Printer's Number 319, was introduced and referred to the Senate Finance Committee on March 9, 2007.

Bill ID: Senate Bill Number 283, Printer's Number 320

System: City of Pittsburgh Municipal (Nonuniformed) Pension Fund

Subject: Continuation of Surviving Spouse's Benefit Regardless of Remarriage

SYNOPSIS

The bill would amend the act of May 28, 1915, (P. L. 596, No. 259), known as the Second Class City Employee Pension Law by removing the current requirement in the Law that the pension payments to a surviving spouse of a member cease upon remarriage.

DISCUSSION

The Second Class City Employee Pension Law (Law) is one of the statutes governing pension plans operated by the City of Pittsburgh. The Law provides for the establishment of a defined benefit pension plan for full-time, nonuniformed employees of the City of Pittsburgh and full-time employees of the Pittsburgh Water and Sewer Authority.

As of January 1, 2005, there were 1,815 active members of the plan, and 1,688 retired members and survivors receiving benefits. This number includes 62 surviving spouses receiving benefits. The current survivor benefit provisions of the Law (Section 4.2) are summarized below.

> Under the Law, any retired, married member of the system may elect to reserve up to $100 per month from the member's retirement benefit to provide a $100 per month benefit to the member's surviving spouse payable for life or until remarriage.

In 1987, the City of Pittsburgh established, by ordinance (Ordinance Number 14-1987), an additional benefit tier known as Municipal Benefit Plan No. 2, which is applicable to members of the nonuniformed municipal pension plan who were hired by the City on or after January 1, 1988 (see Pittsburgh City Code, Sections 192.20 through 192.33). Section 192.27 of Municipal Benefit Plan No. 2 provides for additional survivor benefit options previously not available to members of the City's municipal pension system for nonuniformed employees. Because the bill amends only the Second Class City Employee Pension Law, the bill will have no effect upon the survivor benefit provisions provided under the aforementioned City ordinance. Removal of the cessation of annuity due to remarriage provisions currently contained in the City Code would require separate action by the City of Pittsburgh. The following summarizes the survivor benefit provisions of Section 192.27 of the City Code.

<u>Pre-Retirement Death Benefit</u>.

1) In the event of the death of an active member who has accumulated at least eight years of credited service and has attained the age of 50 years, a surviving spouse shall be entitled to receive a survivor benefit equal to 50% of the pension benefit to which the deceased member would have been entitled had the member retired on the day before his or her death, payable for life or until the surviving spouse remarries; or

2) In the event of the death of an active member who has not yet accumulated eight years of credited service and attained age 50, the member's designated beneficiary(ies) shall be entitled to a return of the member's accumulated contributions to the pension plan with interest, or in the absence of a designated beneficiary, the accumulated contributions will be paid to the deceased member's estate.

Postretirement Death Benefit.

If elected by the member at retirement, a survivor spouse benefit equal to 50% of the pension benefit the deceased member was receiving at the time of death, actuarially reduced by an amount dependent upon the difference in age between the deceased member and the survivor spouse, and payable for life.

Because survivor beneficiaries are generally made aware of the benefit cessation provisions of the plan, in practice, the instances in which benefits to survivors (spouses or children) are terminated because of remarriage are quite rare. The bill would amend the Law by removing the current provisions requiring that the pension payments to a surviving spouse of a member cease upon remarriage.

Statutory provisions requiring the termination of survivor spouse benefits upon remarriage were once a common feature of municipal pension plans and are based upon an orientation toward survivor benefits that is no longer deemed to be appropriate. Similar provisions were previously applicable to police officers employed by the City of Pittsburgh, firefighters and police officers under The Third Class City Code, and police officers in boroughs, incorporated towns, townships, and regional police departments under the Municipal Police Pension Law, but these provisions have since been repealed. Under the pension plans for nonuniformed employees of the City of Scranton and the standard pension plans administered by the Pennsylvania Municipal Retirement System, at the time of retirement, a municipal employee may elect to receive a single life annuity or, if the retiring employee wishes to provide financial assistance for dependents who may outlive the retiree, an employee may choose from one of several benefit options designed to provide survivor benefits for one or more designated beneficiaries. In neither system do any of the survivor options available to members terminate the retirement benefits to a surviving spouse upon remarriage.

SUMMARY OF ACTUARIAL COST IMPACT

The consulting actuary of the City of Pittsburgh has informed the Commission staff that the probability of remarriage for surviving spouses of deceased members is not valued by the actuary in preparing the actuarial valuations of the pension system. Accordingly, there will be no change in the funding requirements of the plan upon enactment of the bill. Likewise, the consulting actuary of the Commission has reviewed the bill and determined that there will be no significant actuarial cost impact upon the City of Pittsburgh Municipal Pension Fund resulting from passage of the bill.

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations:

Removal of Outdated Provisions. The bill removes provisions in the Second Class City Employee Pension Law that are based upon an orientation toward survivor benefits that is no longer appropriate.

POLICY CONSIDERATIONS (CONT'D)

Outdated Provisions Retained. The bill does not remove provisions in the City Code that requires the cessation of survivor spouse benefits upon remarriage. Removal of this provision would require separate action by the City of Pittsburgh. If the removal of outdated survivor provisions is viewed as desirable, this additional provision also should be removed.

COMMISSION RECOMMENDATION

On March 20, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

Senate Bill Number 283, Printer's Number 320, was introduced and referred to the Senate Finance Committee on March 9, 2007.

Bill ID: Senate Bill Number 596, Printer's Number 1759

System: State Employees' Retirement System,
Public School Employees' Retirement System and
Municipal Police Pension Systems

Subject: Statewide Local Government Police Employee Retirement System

SYNOPSIS

Senate Bill Number 596, Printer's Number 1759, would amend the Public School Employees' Retirement Code and the State Employees' Retirement Code by mandating the establishment of a centrally administered statewide retirement system for all local government police employees. A local government is defined by the bill as any municipality, excluding a county. The bill will systematically implement a gradual consolidation and integration of the existing decentralized local police pension plan structure into a single statewide system to be known as the Government Employees' Retirement System. The new system will be of a size, scope and structure intended to assure fiscal and actuarial stability, proper funding, benefit adequacy, benefit equity and security, administrative cost savings and increased efficiency, prudent investment of assets, enhanced member services, and employee portability.

DISCUSSION

Pennsylvania currently has approximately 971 pension plans for municipal police employees, representing one-third of all municipal pension plans in the Commonwealth. Based upon 2005 Act 205 reporting period data, including the City of Philadelphia, these plans had a total of 17,650 active members, with an average membership of 18.2 members per plan. Three hundred fifty-six (356) of the police plans, or 36%, had three or fewer active members; and three hundred twenty-eighty (328) plans, or 34%, had from 4 to 10 members. In total, these 971 police pension plans were paying benefits to approximately 18,963 retired members and beneficiaries. It should be noted that the City of Philadelphia represents approximately 35% of the active membership and 54% of the retired members and beneficiaries.

The transition to a statewide system will occur gradually through the mandatory participation of police employees hired after the later of January 1, 2010, or the expiration of a current collective bargaining agreement that would otherwise require new hires to participate in the local government's police pension plan. Under the bill, a local government police pension plan established prior to January 1, 2010, may continue to operate until either all of the plan's current members and beneficiaries are voluntarily transferred to the new statewide system, or until the local police pension plan no longer has members or beneficiaries representing actual or potential liabilities. The bill permits the continuance of existing, self-administered local government retirement systems, but it prohibits the establishment of any new police retirement systems by local governments except through participation in the Government Employees' Retirement System. Provisions are also included in the bill for the optional participation by current employees, provided that both the affected municipality and the employees agree on the terms of participation and that all existing pension liabilities are fully-funded prior to participation.

For the purposes of this analysis, the Commission staff and the Commission's consulting actuary have assumed that no existing police pension plans will voluntarily transfer current members into the statewide plan. Instead, the Commission's consulting actuary has assumed that only police employees hired after December 31, 2009, will become members of the statewide plan, as mandated by the bill. The actuary's assumption results in the gradual recognition of the aggregate effects of full implementation of the statewide plan over the course of 20 years, after which time practically all local government police officers will be members of the statewide system.

Organization and Administration

Under the bill, the new statewide retirement system for police employees will be administered under the auspices of an existing state agency – the State Employees' Retirement System (SERS). The State Employees' Retirement System possesses both the necessary staff and expertise to effectively administer such a large retirement plan. Under the bill, SERS will be administratively combined with the statewide local government police employees' retirement system to form a consolidated entity that will be known as the Government Employees' Retirement System (GERS).

To permit local governments to retain control of pension fund assets and to ensure there is no potential for the transference of State costs to local governments, the bill provides for asset management and funding determination functions to be segregated and controlled by a Local Government Employees' Retirement Board that is separate and distinct from the State Employees' Retirement Board. Although combined for administrative purposes, the assets used to fund the benefits of police employees will be accounted for separately from the assets used to fund the benefits of state employees. The Board's membership will consist of six members (three local government officials or employees, and three active or retired local government police employees) appointed by the Governor with the advice and consent of the Senate. The Local Government Police Employees' Retirement Board will administer the Local Government Employees' Retirement Fund and will have powers and duties essentially identical to those of the State Employees' Retirement Board.

Administrative Expenses

Municipal governments are increasingly required to react to multiple levels of state and federal legislation concerning tax and other employment related issues. Within Pennsylvania's decentralized system, the availability and accuracy of reliable data are accordingly becoming more critical. Plan documents, including demographics, earnings, and payment records, must be maintained over the active and retired life of employees, which often exceeds fifty years. Small municipalities very often lack the administrative continuity to perform these functions on a long-term basis.

Additionally, the high per-member costs associated with administering so many small municipal plans has long been a concern of the Commission. These administrative costs are significantly greater for most local government police plans than for either large municipal plans, such as the City of Philadelphia, or for statewide plans such as the State Employees' Retirement System (SERS). A review of the Commission's 2005 Act 205 reporting data revealed that the average per-member administrative cost for the Commonwealth's approximately 971 local government police pension plans (including Philadelphia) was $950.

The Commission's consulting actuary estimated the administrative cost savings associated with the consolidation of administrative functions through the proposed statewide retirement system. Based upon the average per-member administrative costs under SERS of $193, the reduction in annual administrative expenses in year 20 would be approximately $24.2 million, or 1.30% of total projected payroll. The relative administrative efficiency and effectiveness of a single, consolidated statewide retirement system over the administration of large numbers of very small municipal plans is evident.

Actuarial Cost Methodology

Actuarial cost methodology is used in the administration of a retirement system to determine a total cost that is systematically funded in advance of the actual pension benefit payments. Actuarial cost methodology is used to assure the predictability of the ongoing funding requirements of the retirement system. The broad base of demographic experience afforded by a pension plan with a large membership allows greater accuracy in the choice of actuarial assumptions and consequently improves the reliability of the actuarial cost determinations. However, when actuarial cost calculations are performed for a pension plan with a small membership, there is a limited base of demographic experience upon which to base the choice of actuarial assumptions. Because actuarial assumptions are largely based on statistical averages, the size of the plan directly affects the probability of the predicted events being realized. In the absence of an adequate experience base, the selection of accurate actuarial assumptions is difficult, and the reliability of the actuarial cost determinations is reduced. As stated previously, a review of the Commission's 2005 Act 205 reporting data reveals that the average membership of police pension plans in the Commonwealth is approximately 18.2 members per plan. No accepted actuarial cost method can be reliably applied to these small pension funds.

Investment of Plan Assets

Investment management is another function that demonstrates the relative inefficiency of the current decentralized structure of local government police employee retirement systems. In addition to compounding the direct costs attributable to the investment function, the dispersed investment activity limits access to certain investments that require minimum threshold deposits and impedes the level of diversification that would be available to a larger fund. To the extent that the lack of investment diversification or the limited access to investment vehicles diminishes earnings, the current decentralized structure of local government retirement systems increases the pension costs that must be financed with tax revenues.

Comparing the investment performance of local government police employee retirement systems to that of SERS further illustrates the negative impact that the current system of decentralized investment management has on local governments. In making this comparison, the Commission was confined to comparing reported rates of return in the even-numbered calendar years from 1996 through 2004, even though these were years of relatively low investment returns for SERS. The use of these time periods is compelled by the alternate year municipal reporting established by Act 205 and the lack of data concerning unrealized capital gains and losses in municipal plans other than the city of Philadelphia prior to the 1997 Act 205 filing period. This analysis evinced a non-Philadelphia municipal investment return rate of 4.6%, while SERS achieved a return of 7.2% during the same time-frame, for a difference of 2.6%. Comparing SERS to Philadelphia's fiscal data at the same time points[1] resulted in Philadelphia returns of 9.6% and SERS returns of 13.0%, for a difference of 3.4%. Weighting those results to conform to the fact that Philadelphia holds thirty-four percent (34%) and the remaining municipal police pension plans hold sixty-six percent (66%) of total police pension fund assets leads to a total difference between SERS and the aggregated municipal rate of return of 2.8%. If all assets, liabilities, and active and retired memberships were transferred to a single statewide system, an increase in investment returns would, therefore, be expected. As the data in the following table shows, even a one percent increase in future investment returns would yield an additional increase in revenues of approximately $35 million (after full implementation).

[1] The City of Philadelphia's pension plans report investment earnings on a fiscal year basis ending June 30, while the State Employees' Retirement System reports on a calendar year basis, ending December 31 of each year. The comparison was made between Philadelphia's fiscal results and SERS' mid-year investment returns.

The following table is intended to illustrate the potential annual increase in investment returns based upon four projected investment return scenarios.

Potential for Increased Investment Earnings Resulting from Statewide Plan

Assumed Increase in Investment Return	Reduction in Employer Costs in Dollars [2]	Reduction in Employer Costs as a % of Projected Payroll [2]
1%	$ 35,000,000	1.88%
2%	$ 71,000,000	3.82%
2.8% [3]	**$ 99,000,000**	**5.32%**
3%	$106,000,000	5.70%

Even a very conservative evaluation of the data demonstrates that a statewide retirement system for municipal police employees would reduce the government revenues needed to finance police pension benefits while effecting an improved benefit structure for most municipal police officers that is both equitable and uniform.

Benefit Structure

Much of the benefit disparity of municipal police pension plans results from the confusing and sometimes conflicting state laws governing police pension benefits. There are more than a dozen state laws, many of which have been amended repeatedly, that directly affect the benefits to be provided to municipal police officers. Most municipal police pension plans have a benefit structure with a basic benefit of 50 percent of final average salary, after meeting age and service requirements. Some plans, however, provide benefits as low as 20 percent of final salary and some are as high as 80 percent of final salary. The normal cost rates among municipal police plans also vary greatly and are another indicator of the disparity in benefits. Normal costs, when stated as a percentage of payroll, during the 2005 Act 205 reporting period were as low as 3.59 percent of payroll and as high as 39.95 percent of payroll.

Under the bill, benefits for police employees would be determined in accordance with the current accrual rate system used to calculate retirement benefits for SERS members. Under the SERS Code, the pension benefit is determined using a formula which is the product of a basic accrual rate multiplied by the member's years of credited service, multiplied by the member's final average

[2] The Reduction in Employer Costs in Dollars is based upon the projected future payroll at a specific time that is twenty years after implementation of the bill. The percentage changes are not dependent upon that payroll projection and are ongoing into the future.

[3] As previously discussed, the Commission staff believes the 2.8% increase expectation to be the most reasonable, based upon a review of the most recent five Act 205 biennial reporting periods (10 years) of average investment returns of municipal police plans compared with the average investment returns of SERS over the same alternate year time period.

salary (average of the highest three years of income) multiplied by the member's class of service multiplier. Under the bill, local governments will utilize four membership classifications to provide police employee pension benefits, and the new membership classifications will be integrated into the existing SERS membership and benefit structure. The following table illustrates the four police employee classifications and their corresponding benefit structures:

Classification	Benefit Accrual Rate [4]	Superannuation Age	Member Contribution Rate
Class P1	2.5% for first 20 years; 2.0% for years over 20	Age 50 or 20 years of service	6.25% for first 20 years; 5.0% for years over 20
Class P2	2.25%	Age 50	5.625%
Class P3	2.0%	Age 50	5.0%
Class P4	1.75%	Age 55	4.375%

The bill provides for employee participation in the selection of the benefit classifications in instances where pension benefits are now being provided and it assures that the pension benefits of current employees are not reduced. Ancillary benefits, including vesting, disability and death benefits, are in accordance with the existing SERS benefit structure.

Additionally, the bill requires the Local Government Police Employees' Retirement Board to establish a supplemental local government retirement benefit accumulation plan, which is a voluntary program to be funded through matching employer and employee contributions accumulated in individual employee accounts that may be used to provide supplemental benefits in retirement.

The bill also authorizes the provision of retirement benefits for part-time local government employees and specifies the use of simplified individual retirement accounts under section 408 of the IRS Code, and requires that the variable annual contributions be specified as a uniform percentage of compensation.

In making his cost projections, the Commission's consulting actuary assumed that the collective bargaining process would ultimately result in all municipal pension plans providing one of the highest two levels of plan benefits, either P1 or P2. He then estimated the aggregate effect of the change in benefit structure proposed in the bill assuming full implementation after 20 years, based upon a future total active membership of approximately 17,600 police employees with a projected payroll of $1.86 billion, an interest rate assumption of 8.5%, assumed salary increases of 5.5% per year, and utilizing the mortality assumptions currently applied to SERS active members. The actuary estimated that the aggregate normal costs in year 20 for the 17,600 active members would be approximately $252 million, or 13.55% of total projected payroll, representing an aggregate increase in normal cost of approximately $78 million, or 4.19% of projected payroll.

[4] This Benefit Accrual Rate consists of the basic accrual rate (2.0%) multiplied by the appropriate class of service multiplier to arrive at the annual benefit accrual rate.

Employee Contributions

The bill requires all active members of the statewide plan to make employee contributions to the plan that correlate to the member's class of service. The employee contribution requirements are displayed in the following table.

Classification	Member Contribution Rate
Class P1	6.25% for first 20 years; 5.0% for years over 20
Class P2	5.625%
Class P3	5.0%
Class P4	4.375%

Under the existing system, the Commission's consulting actuary estimated employee contributions in year 20 of approximately $75 million, or 4.03% of total projected payroll. Under the proposed statewide plan, the actuary estimated that projected annual employee contributions to the statewide system would be approximately $111 million, or 5.97% of total projected payroll. Upon full implementation of the statewide plan after 20 years of transition, the result would be a net increase in employee contributions to the statewide plan of approximately $36 million, or 1.94% of total projected payroll.

Portability

The current lack of portability among police pension plans prevents an employee from transferring pension rights and benefits from one municipal employer to another in conjunction with job changes. Accordingly, many police employees are restricted in their ability to achieve their full career potential. Employers also lose significant flexibility because of the impediment lack of portability imposes on the selection of employees from other municipalities. Under the current decentralized system, it is impracticable to establish an equitable method to value and transfer assets and service credits among municipalities with varying benefit structures, funding mechanisms and funded conditions.

The single, statewide system provided for under the bill provides complete portability for municipal police employees and provides professional police employees the retirement advantages of a single statewide employer.

Effects on Pension Funding

As local police pension plan membership and associated costs are gradually transitioned to the statewide system, more of the cost of funding police pension benefits will shift to the police members, to the same extent as now required of State employees. This will alleviate some of the burden currently imposed upon local taxpayers. To the extent that the need for State aid to municipalities declines, the bill provides a mechanism for handling residual funds by requiring that any unallocated funds in a given year be held in reserve for allocation in the subsequent year. In the event that the unallocated moneys in any year exceed 10% of the total moneys available for allocation in that year, the excess funds will be paid into the Commonwealth General Fund.

SUMMARY OF ACTUARIAL COST IMPACT

The following table depicts the projected aggregate impact of the proposed statewide plan, with an estimated future payroll of $1.86 billion, and with full implementation in 20 years.

	As a Dollar Amount	As a % of Projected Payroll
Increase in Employer Cost		
Projected Increase in Aggregate Normal Costs	$ 78,000,000	4.19%
Offset to Employer Cost		
Projected Increase in Employee Contributions [5]	36,000,000	1.94%
Projected Reduction in Administrative Expenses	24,200,000	1.30%
Projected Increase in Return on Investments [6]	99,000,000	5.32%
Total Projected Employer Annual Cost Savings	**$81,200,000**	**4.37%**

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations:

Statewide Plan. The establishment of a statewide municipal police pension plan would remedy the problems of ineffective and inefficient administration, lack of portability, and disparity in benefit structure. Additionally, a statewide system would, when fully implemented, significantly reduce employers' municipal police pension costs, provide for reliable actuarial funding, enhance membership services, and provide equitable retirement benefits to the Commonwealth's municipal police officers.

Gradual Implementation. The extended transition period for implementation of the statewide local government police employees' retirement system is provided to prevent the disruptive effects that would most likely occur with immediate implementation. The long transition period will also facilitate the administrative changes needed to accommodate implementation of the new system.

[5] The projected increase in employee contributions over projected local police pension plan contribution levels results in a corresponding decrease in future employer contribution requirements.

[6] Based on an estimated average 2.8% increase in investment return over municipal return rates resulting, in part, from the consolidation of assets made possible in a statewide plan.

POLICY CONSIDERATIONS (CONT'D)

Administrative Efficiency. Implementation of a statewide retirement system for local government police employees will enable the consolidation of administrative functions, increasing efficiency and significantly reducing costs associated with providing employee retirement benefits.

Determination of Actuarial Funding Requirements. The bill resolves the present difficulties in the application of actuarial cost methods in numerous small plans by consolidating the membership of the approximately 970 police pension plans into a single retirement system.

Centralized Investment Management. The consolidation of assets and centralization of investment management functions provided for in the bill will serve to maximize potential investment earnings and reduce the risks of adverse investment experience.

Benefit Portability. A statewide retirement system for local government police employees will ensure pension benefit portability for police employees. The transfer of retirement service credits between local governments will eliminate a substantial impediment to police employee mobility, facilitating recruitment, and providing more equitable retirement benefits when a public safety career involves service with more than one government entity.

Benefit Uniformity. Because local governments will provide more uniform benefits within the parameters provided by a statewide system, the competitive pressure on police employees to achieve higher benefits will diminish, and the benefit provisions will be more widely understood and accessible.

Enhanced Member Services. The statewide system provided for in the bill will ensure an adequate and consistent level of retirement-related services to police employees.

Provision for Cost Sharing. The provision in the bill requiring increased member contribution rates consistent with the enhanced benefit structure appears to be a reasonable public pension policy approach.

Drafting Issues. On September 28, 2007, the Commission staff received a memorandum from SERS entitled "Plan Design Issues on Consolidating Municipal Employees' Pensions with SERS." The memorandum described a number of substantive and technical issues regarding the statewide plan envisioned under the bill that were of concern to SERS. The Commission staff is currently working with SERS and Senate staff to resolve these issues and to provide any technical drafting assistance to the bill sponsors required to effectuate necessary changes through future amendments to the bill.

COMMISSION RECOMMENDATION

On March 20, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

Senate Bill Number 596, Printer's Number 1759, had first consideration in the Senate on February 11, 2008, and was re-committed to the Senate Finance Committee on March 10, 2008.

Bill ID: House Bill Number 639, Printer's Number 700

Systems: All Municipal Police Officers' and Firefighters' Retirement Systems

Subject: Mandating Municipalities to Pay Automatic Annual Postretirement Cost-of-Living Adjustments to Retired Municipal Public Safety Employees

SYNOPSIS

House Bill Number 639, Printer's Number 700, would create the Annual Municipal Employee Postretirement Adjustment Act, requiring affected municipalities to pay an annual postretirement cost-of-living adjustment (COLA) to all eligible retired municipal police officers and firefighters in an amount equal to the change in the amount of the Consumer Price Index (CPI) for the previous year, less 0.5%, up to a maximum of 5.0% annually.

DISCUSSION

As of January 1, 2007, there were 1,042 municipal pension plans for police officers and firefighters operating in the Commonwealth, covering a total of 22,665 active members, 16,083 retired members and 4,142 disabled members. As of January 1, 2007, the active member payroll totaled approximately $1.3 billion annually, and the annual annuity payroll totaled approximately $497 million.

The Commonwealth imposes a two percent tax on the premiums of casualty and fire insurance policies sold in Pennsylvania. The Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) establishes a General Municipal Pension System State Aid program financed from the proceeds of the casualty insurance premium tax and a portion of the fire insurance premium tax on policies sold by out-of-state ("foreign") insurance companies. The act provides for the allocation of these funds to municipalities for the purpose of offsetting the costs of funding municipal pension plans in accordance with the funding standard imposed by the act. The amounts available for distribution under the State aid program are dependent upon the insurance markets and, therefore, vary from year to year. In 2008, a total of $206.5 million is available for distribution under the General Municipal Pension System State Aid program.

A postretirement adjustment is a special type of retirement benefit. It is an increase in the amount of the retirement benefit that initially was payable at retirement. Postretirement adjustments may be granted for a number of reasons, but the most common is to increase retirement pay to reflect part of the increase in the cost of living since an individual retired. In Pennsylvania, some local governments have provided postretirement cost-of-living adjustments to retired municipal employees. The General Assembly has also enacted statewide cost-of-living adjustments for certain municipal retirees on an ad hoc basis.

In 1988, the General Assembly enacted and the Governor signed into law the Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act (Act 147 of 1988). Act 147 mandated every Pennsylvania municipality that maintains a police officers' or paid firefighters' retirement system to provide special ad hoc postretirement adjustments in the pension benefits for certain retirees. The state-mandated special postretirement adjustments were provided without regard to the provision of postretirement adjustments by the individual retirement systems.

The formula for the cost-of-living adjustments in Act 147 was based upon the number of years on retirement using three benefit groupings (5 – 10 years, 10 – 20 years, and 20 or more years), and it included a special benefit grouping for disabled retirees with less than ten years on retirement.

In 2002, Act 147 was amended by Act 64 of 2002 to mandate an additional postretirement adjustment for municipal public safety employees. Retroactive to January 2001, Act 64 mandated every Pennsylvania municipality subject to Act 147 to pay an additional monthly ad hoc postretirement adjustment to retirees who began receiving a retirement benefit before January 1, 1996, calculated as the sum of a base adjustment and a longevity adjustment. Under the act, the base adjustment was the product of 15 cents multiplied by the years of service multiplied by the years on retirement. The longevity adjustment was the product of the base adjustment multiplied by the sum of the products of multiplying 0.025 by the years on retirement and 0.05 by the years on retirement in excess of 25, if any.

Act 64 contained benefit offsets that required a reduction in the special ad hoc postretirement adjustments for adjustments provided by the municipal retirement system if the total assets in the pension trust fund of the municipality were less than 50 percent of its aggregate actuarial accrued liabilities. Also, if a retiree was entitled to be paid a special adjustment by more than one municipal retirement system, the benefit adjustment was reduced so that the total of all adjustments would not exceed the adjustment as calculated above. If the retiree received one or more postretirement adjustments from the local retirement system after December 31, 1988, and before January 1, 2002, the special adjustment was reduced annually by 65 percent of the total amount of the retiree's locally-provided postretirement adjustment paid in the preceding year.

House Bill Number 639 would create a stand-alone act to be known and cited as the Annual Municipal Employee Postretirement Adjustment Act. The bill would mandate affected municipalities to pay an annual postretirement cost-of-living adjustment to all eligible retired municipal police officers and firefighters in an amount equal to the change in the amount of the Consumer Price Index (CPI) for the preceding year, less 0.5%, up to a maximum of 5.0% annually. Under the bill, an eligible annuitant would be: 1) a retired police officer or firefighter who has terminated active employment with the municipality; 2) a retired police officer or firefighter who is receiving a retirement annuity, retirement benefit, service pension or disability pension benefit; and 3) a retired police officer or firefighter who began receiving a retirement benefit prior to April 1 of the prior year. The annual adjustment is prospective only and would become effective April 1 of each calendar year provided the retiree began receiving retirement benefits before April 1 of the prior year. The bill requires a municipal retirement system to pay the annual adjustment "as soon as practicable" and provides for the retroactive payment of any omitted amounts caused by a delay in the payment of the annual benefit increase.

Although the benefit entitlement provided by the bill is an ongoing annual benefit adjustment and differs significantly from the ad hoc benefit enhancements provided by both Act 147 and Act 64, the bill utilizes operational language and funding provisions similar to those contained in Act 147 and Act 64. Under the bill, the Commonwealth would reimburse affected municipalities for the increase in the amortization contribution requirements attributable to the mandated annual adjustment. The reimbursement would be equal to the amortization contribution requirement attributable to the postretirement adjustment that was paid from municipal revenues other than General Municipal Pension System State Aid. For purposes of the reimbursement, the increase in a municipality's amortization contribution requirement would be calculated as the amortization contribution requirement attributable to the annual adjustment reflected in the determination of the financial requirements of the retirement system under Chapter 3 of the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) for the immediate prior year less the product of that amortization contribution requirement multiplied by the ratio of the amount of General Municipal Pension System State Aid allocated to the retirement system in the immediate prior year to the total amount of municipal contributions made to the retirement system from all sources other than employee contributions in the immediate prior year.

For a retirement system under a defined benefit pension plan for which the municipality determines the financial requirements under Section 302 of Act 205, the term "amortization contribution requirement" would mean the amortization contribution requirement attributable to the annual adjustment that was reflected in the financial requirements of the system determined for the immediate prior year.

For a retirement system under a pension plan without defined benefits for which the municipality determines the financial requirements under Section 303 of Act 205, the term "amortization contribution requirement" would mean the sum of the payments made to the retirement system in the immediate prior year in order to provide the annual adjustment.

The bill provides no benefit-offset provision for cases in which an eligible retiree is already receiving or has received a cost-of-living adjustment provided by the municipality. Likewise, no benefit offset is permitted for underfunded pension plans.

The bill mandates postretirement adjustments for members of police officers' retirement systems that, together with the adjustments already provided under Act 147, Act 64 and potentially by the municipality, may exceed the limits for such increases specified in the Municipal Police Pension Law (Act 600 of 1955), which governs most borough, town, township, and regional police departments. The bill contains specific language (bill Section 1101) permitting affected municipalities to pay the cost-of-living adjustments provided by the bill notwithstanding the benefit limitations otherwise imposed by Act 600. The bill also contains language that repeals all acts or parts of acts that may be in conflict with the bill's provisions.

The bill specifies that the proceeds of the premium tax on casualty insurance sold in Pennsylvania by out-of-state insurance companies is to be used to pay for the annual benefit increase, with any remaining amounts continuing to be used for General Municipal Pension System State Aid. As with the previous statewide municipal postretirement adjustments, the bill's funding mandate would serve to reduce the State aid available for allocation to municipalities to offset their employer pension costs. Because no new money is appropriated, the total costs of the benefits mandated by the bill will ultimately be funded by the affected municipalities. Moreover, even those municipalities that do not maintain a pension plan for public safety employees will be negatively affected by the bill because the bill would reallocate State aid revenue to fund the COLA benefit, significantly reducing and nearly eliminating the State aid available to these communities.

SUMMARY OF ACTUARIAL COST IMPACT

The actuarial cost impact of the bill will vary from municipality to municipality depending upon the average retirement age and the number of retired members. The bill, if enacted, would mandate payment of the CPI-based automatic annual COLA to any eligible retiree. As the bill is written, this would include future retirees in addition to current retirees. Therefore, in addition to increases in aggregate actuarial accrued liabilities, there would be an increase in aggregate normal costs resulting from the benefit enhancement. In preparing the cost estimate, the Commission's consulting actuary assumed an annual increase in the CPI of 4.0%, resulting in projected annual COLAs for eligible retirees of 3.5%. Using demographic data on municipal police and firefighter pension plans extracted from the Commission's database and data from a sample of 50 municipal police and firefighter pension plans, the consulting actuary of the Commission provided the estimate of the aggregate statewide actuarial cost impact of the bill shown in the following tables.

Table I

Actuarial Cost Impact Attributable to Current Retirees

	Amount
Increase in Aggregate Actuarial Accrued Liabilities	$1,430,000,000 — $2,150,000,000

	Amount	As a % of Payroll
Increases in Employers' Annual Costs		
Normal Costs	$ 0 — $ 0	0.00% — 0.00%
Amortization Payments [1]	196,000,000 — 294,000,000	14.45% — 21.67%
Total Increases in Employers' Annual Costs	$196,000,000 — $294,000,000	14.45% — 21.67%

[1] 10-year level-dollar payments assuming a 7.75% annual interest rate.

Table II

Actuarial Cost Impact Attributable to Current Active Members (Future Retired Members)

	Amount
Increase in Aggregate Actuarial Accrued Liabilities	$1,260,000,000 — $1,890,000,000

	Amount	As a % of Payroll
Increases in Employers' Annual Costs		
Normal Costs	$ 60,000,000 — $ 90,000,000	4.42% — 6.63%
Amortization Payments [1]	140,000,000 — 210,000,000	10.32% — 15.48%
Total Increases in Employers' Annual Costs	$200,000,000 — $300,000,000	14.74% — 22.11%

[1] 14-year level-dollar payments assuming a 7.75% annual interest rate.

Table III

Total Actuarial Cost Impact

	Amount
Increase in Aggregate Actuarial Accrued Liabilities	$2,690,000,000 — $4,040,000,000

	Amount	As a % of Payroll
Increases in Employers' Annual Costs		
Normal Costs	$ 60,000,000 — $ 90,000,000	4.42% — 6.63%
Amortization Payments [1]	336,000,000 — 504,000,000	24.77% — 37.15%
Total Increases in Employers' Annual Costs	$396,000,000 — $594,000,000	29.19% — 43.78%

[1] Level-dollar payments assuming a 7.75% annual interest rate for the first 10-years following implementation. These figures comprise the total amortization contribution requirement resulting from the increase in accrued liability attributable to both retired members and the past service of current active members. Additionally, the level-dollar amortization payments shown in Table II will be required for four more years beyond the initial 10–year amortization period before the total increase in accrued liability attributable to the benefit enhancement applicable to current active members is fully amortized.

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy issues:

Unfunded Mandate to Municipalities. The bill mandates annual CPI-based benefit increases to be paid to retired members of all municipal public safety employees' retirement systems. Because no new funding source has been identified, the total costs of the benefits mandated by the bill will need to be funded by the affected municipalities.

Reallocation of State Pension Aid. The purpose of the General Municipal Pension System State Aid program is to provide state government revenue to municipalities to help offset current pension costs. Because of the substantial actuarial costs of the benefit enhancement, the bill would have the effect of reallocating substantially all of the foreign casualty insurance premium tax receipts now used for State aid to the purpose of funding the COLA benefit provided by the bill. These annual shortfalls in State aid revenues will need to be made up entirely from municipal tax revenues.

Serious Budgetary Difficulties. The redistribution of General Municipal Pension System State Aid resulting from enactment of the bill would most likely result in serious future budgetary difficulties for most municipalities. Because nearly all of the revenue available for the State aid program would need to be reallocated to fund the costs of the COLA benefits provided by the bill, the ongoing costs of maintaining municipal pension plans will need to be funded almost entirely from revenues generated at the local level.

Absence of Benefit Offsets. Unlike Act 64 of 2002, the bill contains no provision to offset or reduce benefit increases in cases where cost-of-living adjustments may have been previously granted to retirees by affected municipalities, nor does the bill contain any exemptions or special provisions for distressed or otherwise poorly funded pension plans.

Inequitable Treatment of Retired Municipal Employees. The bill is limited in application to retired municipal public safety employees. There is limited policy rationale for the Commonwealth to distinguish between municipal public safety employees and nonuniformed municipal employees in mandating postretirement benefit increases, particularly when substantial state government revenue is involved.

Definition of "Consumer Price Index." There are multiple variations of the Consumer Price Index. The bill should be amended to include a definition of Consumer Price Index that will clarify precisely which calculation of Consumer Price Index is to be used in the determination of the annual COLA provided by the bill.

COMMISSION RECOMMENDATION

On September 25, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 639, Printer's Number 700, was introduced and referred to the House Finance Committee on March 6, 2007.

Bill ID: House Bill Number 1737, Printer's Number 2315

System: Philadelphia City Firefighters

Subject: Continuation of Surviving Spouse's Benefit for Life Regardless of Remarriage

SYNOPSIS

House Bill Number 1737, Printer's Number 2315, would:

1) prohibit the City of Philadelphia Municipal Retirement System from denying any benefit, including pension payments, service-connected death benefits, or service-connected health care benefits to a surviving spouse of a firefighter or fire department employee, including a pensioner and employee of the fire department, as a result of the remarriage or subsequent marriage of the surviving spouse;

2) repeal Act 242 of 1915 insofar as it is inconsistent with the prohibition in the bill; and

3) repeal portions of the First Class City Home Rule Act (and, as a result, the home rule charter adopted under the act and ordinances adopted under the charter) insofar as they are inconsistent with the provisions of the bill.

DISCUSSION

Act 242 of 1915 was among the statutes that established the pension plan for the City of Philadelphia municipal employees prior to the adoption of the City's home rule charter under the First Class City Home Rule Act. Section 4.1 of Act 242 (53 P. S. § 13437) provides that the pension to be paid to a surviving spouse shall continue to be paid during the lifetime of a surviving spouse, unless a surviving spouse remarries, in which case payment of the survivor benefit is to be terminated.

According to the most recent actuarial valuation report for the City of Philadelphia on file with the Commission, as of July 1, 2005, there were 1,875 firefighters who were active members of the City of Philadelphia Municipal Retirement System. The system was paying benefits to 2,195 retired members (including Deferred Retirement Option Plan (DROP) participants), 468 disabled members, 861 surviving spouses, and 77 other beneficiaries including surviving children.

Under its home rule charter, the City has provided for its Municipal Retirement System through enactment of the City's Retirement System Ordinance approved December 3, 1956, and the City's Municipal Retirement Benefit Plan Ordinance effective January 8, 1987. The bill would repeal provisions of Act 242, the First Class City Home Rule Act, the City's home rule charter, and the ordinances adopted under the enabling act and charter, which are inconsistent with the bill's provision permitting surviving spouses to continue to receive benefit payments for life, regardless of whether they remarry. The bill is essentially identical to Act 184 of 2004, which removed the "remarriage penalty" provision for spouse beneficiaries of Philadelphia police officers and police employees.

The bill proposes to remove a provision in Act 242 that is based upon an orientation toward survivor retirement benefits that is deemed to be outdated and inappropriate. However, the bill applies only to the surviving spouses of firefighters and fire department employees. The spouse beneficiaries of nonuniformed employees of the City of Philadelphia would remain subject to the current provisions of Act 242, which require termination of survivor spouse benefits upon remarriage.

Statutory provisions requiring the termination of survivor spouse benefits upon remarriage were once a common feature of municipal pension plans. Similar provisions were previously applicable to paid firefighters and police officers under The Third Class City Code, and police officers in boroughs, incorporated towns, townships, and regional police departments under the Municipal Police Pension Law, but these provisions have since been repealed. Under the pension plans for nonuniformed employees of the City of Scranton and the standard pension plans administered by the Pennsylvania Municipal Retirement System, at the time of retirement, a municipal employee may elect to receive a single-life annuity or, if the retiring employee wishes to provide financial assistance for dependents who may outlive the retiree, an employee may choose from one of several benefit options designed to provide survivor benefits for one or more designated beneficiaries. In neither system do any of the survivor options available to members terminate the retirement benefits to a surviving spouse upon remarriage.

SUMMARY OF ACTUARIAL COST IMPACT

The consulting actuary of the City of Philadelphia has informed the Commission that the probability of remarriage for surviving spouses of deceased firefighters is not valued by the actuary in preparing the actuarial valuations of the firefighters' retirement system. Accordingly, there will be no change in the funding requirements of the City of Philadelphia upon enactment of the bill. The consulting actuary of the Commission has reviewed the bill and determined that there will be no significant actuarial cost impact upon the City of Philadelphia's Municipal Retirement System resulting from passage of the bill.

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations:

Removal of Outdated Provisions. The bill removes provisions in Act 242 that are based upon an orientation toward survivor benefits that is no longer appropriate.

Outdated Provisions Retained. The bill does not remove the provisions in Act 242 that require the surviving spouse to have been married to the member for at least five years prior to retirement in order to be eligible for a surviving spouse benefit nor does it remove the provisions in Act 242 that require the surviving spouse to be "dependent" upon the retired member in order to receive survivor benefits. If the removal of outdated survivor provisions is viewed as desirable, these additional provisions also should be removed.

Uniformity and Equity of Pension Benefits. The same Act 242 provisions for termination of surviving spouses' benefits upon remarriage apply to the surviving spouses of nonuniformed employees of the City of Philadelphia as well as to firefighters and fire department employees. If the proposal in the bill is determined to be appropriate, the same modification of survivor benefit provisions should be extended to all public employees of the City.

COMMISSION RECOMMENDATION

On June 25, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 1737, Printer's Number 2315, was referred to the Senate Finance Committee on September 29, 2008.

Bill ID: House Bill Number 2084, Printer's Number 3689

System: Public School Employees' Retirement System and State Employees' Retirement System

Subject: Ad Hoc Cost-of-Living Adjustments and Multiple Service Election

SYNOPSIS

House Bill Number 2084, Printer's Number 3689, would: 1) amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code to provide an ad hoc cost-of-living adjustment (COLA) (referred to as "supplemental annuities" in the governing statutes of the retirement systems) to annuitants of both the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS), commencing with the first monthly annuity payment after July 1, 2008; and 2) amend the State Employees' Retirement Code by opening a temporary "window" (beginning on the effective date of the bill and ending December 31, 2008) for members of SERS who have credited service in PSERS, were once eligible to elect multiple service membership, but who failed to elect multiple service membership within the current 365-day limit imposed by the SERS Code.

To be eligible for the COLA, superannuation and disability annuitants must be receiving an annuity on July 1, 2008, and have an effective date of retirement prior to July 2, 2007. Withdrawal annuitants will not be eligible to receive the COLA until the first day of July coincident with or following attainment of superannuation (normal retirement) age. The bill would also mandate a change in the amortization of the additional liabilities attributable to the COLA provided by the bill and all future COLAs from the currently mandated 10-year level-dollar amortization period to a 20-year level-dollar amortization period with funding commencing July 1, 2009.

DISCUSSION

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer, defined benefit retirement systems. The designated purposes of the Public School Employees' Retirement System and the State Employees' Retirement System (Systems) are to provide retirement allowances and other benefits, including disability and death benefits to public school and State employees.

Membership in the Systems is mandatory for most school and State employees. Certain other employees are not required but are given the option to participate. As of June 30, 2007, PSERS had 264,023 active members and 168,026 annuitants and beneficiaries. As of December 31, 2007, SERS had 109,610 active members and 107,130 annuitants and beneficiaries.

Under the Public School Employees' Retirement Code, superannuation or normal retirement age is age 62 with at least one full year of service, age 60 with 30 or more years of service, or any age with 35 years of service. Under the State Employees' Retirement Code, superannuation or normal retirement age for most members is age 60 with three years of service or any age with 35 years of service, while age 50 is the normal retirement age for members of the General Assembly and certain public safety employees. Temporary provisions of the Codes also have permitted members with 30 or more years of service to retire at any age and receive full retirement benefits with no benefit reduction for retiring prior to normal retirement age. The last such special early retirement provision expired June 30, 1999.

Postretirement Cost-of-Living Adjustments (COLAs)

In the operation of a defined benefit retirement system, a formula determines the retirement benefit that is payable at the time of retirement. If the employer determines that a change in the retirement benefit is warranted after retirement occurs, the benefit augmentation is termed a postretirement adjustment. Postretirement adjustments may be made for various reasons. In the Commission's November 2000 report entitled *Funding Cost-of-Living Adjustments*, three basic categories of postretirement adjustments were identified: remedial, welfare and cost-of-living. Remedial postretirement adjustments are used to correct an error in the retirement benefits provided to one group of retirees or to correct an inequity in the retirement benefits between two groups of retirees. Welfare postretirement adjustments are provided to remedy severe financial hardships experienced by long-term retirees or very short service retirees. Cost-of-living postretirement adjustments, or cost-of-living increases, are utilized to address erosion in the purchasing power of retirement benefits caused by inflation.

Cost-of-living postretirement adjustments in public employee retirement systems are granted for the purpose of maintaining the adequacy of retirement benefits after retirement occurs. In the absence of cost-of-living adjustments, the purchasing power of the retirement benefits is diminished over time due to the effects of inflation. Because one commonly accepted goal of a public employee retirement system is to provide a benefit at retirement that is adequate to meet the needs of the retirement system's retired members, the provision of cost-of-living adjustments to ensure the adequacy of the benefit throughout retirement represents a logical extension of this goal.

Cost-of-living adjustments may be provided automatically or on an ad hoc basis. Ad hoc COLAs may be desirable from an employer perspective because the finite nature of the costs and the discretion in the benefit amount provide the potential for the employer to match the costs to the available financing when implementing ad hoc COLAs. Because their implementation represents a change in the benefit provisions of the retirement system and because the precise amount of the benefit augmentations are not predetermined, ad hoc COLAs provide limited potential for the costs incurred to be prefunded. Instead, the costs of an ad hoc COLA are usually added to the unfunded accrued liability of the retirement system and funded by amortization payments. Since active members will receive no benefit from an ad hoc COLA, the amortization payments are generally made exclusively by the employer.

Historically, Commonwealth policymakers have employed a de facto policy of providing ad hoc cost-of-living adjustments to public employees. Since 1968, postretirement cost-of-living adjustments have been authorized by the Pennsylvania General Assembly for both PSERS and SERS retirees on an ad hoc basis approximately every four to six years, with the incurred unfunded actuarial accrued liabilities being amortized over a 20-year period. The passage of Act 9 of 2001 altered this amortization schedule. The Codes of both SERS and PSERS, as amended by Act 9 of 2001, now require that the unfunded liabilities of COLAs be amortized over a 10-year period, with the amortization payments calculated on a level-dollar basis. The shorter 10-year amortization period is desirable because it serves to reduce the total amount of the required amortization payments associated with future COLAs, lessens the potential for the compounding of amortization payments attributable to multiple COLAs, and increases inter-generational equity by reducing the time elapsed between the service of the COLA recipients and the funding for the COLA benefits. The bill would change the current 10-year amortization period, requiring that the unfunded actuarial accrued liability resulting from the benefit increase be amortized through level-dollar payments over a period of 20 years beginning July 1, 2009.

Under the bill, the amount of the COLA is based on the annuitant's most recent effective date of retirement. The total percentage increase payable to eligible annuitants of both Systems under the COLA is shown in the following table.

Most Recent Effective Date of Retirement	Percentage Increase
July 2, 2006 through July 1, 2007	2.67%
July 2, 2005 through July 1, 2006	4.01%
July 2, 2004 through July 1, 2005	5.85%
July 2, 2003 through July 1, 2004	7.67%
July 2, 2002 through July 1, 2003	8.75%
July 1, 2001 through July 1, 2002	9.15%
July 2, 1997 through June 30, 2001	10.00%
July 2, 1990 through July 1, 1997	15.00%
Prior to July 2, 1990	25.00%

Because cost-of-living postretirement adjustments are specifically utilized to address erosion in the purchasing power of retirement benefits caused by inflation, the determination of financial need is the central element in the design of a postretirement adjustment that is based upon changes in the cost of living. The potential measures of change in the cost of living include: the Consumer Price Index (CPI), the gross domestic product deflator, the employer cost index covering compensation rates in the civilian nonfarm economy, the average increase in compensation paid to all active employees of the applicable employer or the increase in compensation paid to a particular employment position.

The most widely used measure of the change in the cost of living for retirement benefit recipients has been the CPI, which is issued monthly by the Bureau of Labor Statistics of the United States Department of Labor. The CPI is a measure of the relative cost over time of a number of consumer goods and services and is the most widely accepted average measure of the effects of changes in the cost of living.

Recent COLAs granted by the General Assembly for PSERS and SERS annuitants have had the effect of replacing approximately 50% of the cumulative change in the CPI over the applicable period of time. In terms of the proposed percentage increases, the bill resembles the COLAs provided under Act 38 of 2002. The bill differs from Act 38 by including as eligible for the COLAs those annuitants who received the benefit enhancements provided by Act 9 of 2001. As the following table illustrates, the increases proposed by the bill would, when combined with the cumulative effects of previous COLAs, provide cost-of-living increases for eligible annuitants that exceed 50% of the CPI.

Comparison of Cumulative Increase in CPI-U Since Retirement with the Cumulative COLAs Granted to PSERS and SERS Non-Act 9 Annuitants who Retired on July 1 [1]

Year of Retirement	Cumulative Increase in CPI-U to Mar. 2008	Cumulative COLAs prior to House Bill Number 2084			Cumulative COLAs after House Bill Number 2084		
		Actual COLA	% of CPI-U	Lost Purch-asing Power	Actual COLA	% of CPI-U	Lost Purch-asing Power
1985	98%	36%	37%	31%	70%	71%	14%
1986	95	36	38	30	70	73	13
1987	88	35	40	28	69	79	10
1988	80	31	38	28	63	79	9
1989	72	25	35	27	56	79	9
1990	64	22	35	25	53	83	7
1991	57	22	38	22	40	70	11
1992	52	18	34	23	35	68	11
1993	48	16	33	22	33	70	10
1994	44	14	33	20	32	72	9
1995	40	11	28	20	28	70	9
1996	36	10	26	19	26	72	7
1997	33	8	23	19	24	72	7
1998	31	8	24	18	18	59	10
1999	28	6	23	17	17	60	9
2000	24	5	21	15	15	65	7
2001	20	3	15	14	13	62	6
2002	19	2	12	14	12	63	6
2003	16	0	0	14	9	54	6
2004	13	0	0	11	8	60	4
2005	9	0	0	8	6	63	3
2006	5	0	0	5	4	81	1
2007	3	0	0	2	3	106	0

[1] For the January 1, 1989, supplemental annuities, the retiree was assumed to have 30 years of service.

Multiple Service

Multiple service membership involves the combining of PSERS service and SERS service for retirement credit purposes. An individual with prior service credit in one of the retirement systems who, due to a change in employment status, becomes a member of the other retirement system may elect to become a multiple service member.

If an individual elects multiple service membership, the individual receives credit for each type of service in the respective retirement system. An individual cannot receive a combined total of service credit in the two systems of more than one year for service in any one calendar year. The individual's record of service, contributions, and interest in each system remains in that system until the individual applies for a refund or retirement. When the individual applies for retirement, each system separately calculates the individual's retirement annuity. Each retirement system's annuity is calculated based on the average of the individual's three highest years of combined salary in both systems and the individual's contributions, interest, and years of credited service in the system performing the retirement calculation. The combined service credited in both retirement systems is used to determine vesting, early retirement and superannuation retirement eligibility in either retirement system. The amount necessary to fund the annuity payable by the first system is then transferred to the system in which the individual was last active. The two annuities are combined and the retired member receives one monthly check that is paid from the system in which the individual was an active, contributing member prior to retirement. In most cases, the election of multiple service is of benefit to the member because it normally results in a final benefit calculation that is greater than would be the case if the retirement service credit of the two systems were not combined.

Prior to the passage of Act 9 of 2001, the multiple service election period was only 30 days in length. Currently, under both the PSERS and SERS Codes, an eligible active member must elect multiple service within 365 days of becoming a member of the new retirement system. Act 9 also opened a one-time election period applicable to eligible active members of both PSERS and SERS from May 17, 2001, to December 31, 2003.

In some cases, an individual member may have withdrawn contributions and interest from the first retirement system upon terminating service, or in the case of a retired member, may have begun receiving annuity benefit payments. Upon electing multiple service membership in the second retirement system, any annuity payments being made to the individual cease and an individual who is receiving annuity payments from the first system must repay the first system for any annuity payments received or for any withdrawn contributions, plus interest.

The prospect of repaying what may amount to a significant sum of money can sometimes deter an otherwise eligible member from electing multiple service. Some individuals who are otherwise eligible simply choose not to elect multiple service membership, while others may overlook the option in the midst of other matters in the first 365 days of employment with a new employer. Later, some may come to regret their decision, arguing that they should be afforded another opportunity to elect multiple service because they did not fully appreciate the value of the option at the time. For some, an additional issue may involve difficulties in obtaining proper documentation from a previous employer for employment that took place many years in the past.

The bill seeks to rectify past problems with understanding the multiple service election option by providing eligible active members of SERS with a one-time election period, beginning with the effective date of the bill and ending December 31, 2008. Because the bill amends only the SERS Code, only SERS members with previous service credit in PSERS would be eligible for the window. PSERS members wishing to elect multiple service membership would not be eligible to elect multiple service under the proposed election window.

The Commission's consulting actuary has suggested that it may be desirable to entirely eliminate the 365-day limit for multiple service election, and thus, remove any perceived need for future temporary election periods. In order to anticipate and adequately fund for such a scenario, multiple service election by eligible members would be treated by the actuaries of both PSERS and SERS as a certainty. Both PSERS and SERS would routinely collect and periodically share demographic information on all potentially eligible members and update that information on an annual basis.

SUMMARY OF ACTUARIAL COST IMPACT

Cost-of-Living Adjustments

The Commission's consulting actuary has reviewed the bill and the actuarial cost estimates provided by the actuaries of the respective retirement systems and determined that the cost-of-living adjustments provided by the bill will have the following actuarial cost impact.

Public School Employees' Retirement System

	Amount	
Increase in Unfunded Actuarial Accrued Liability	$3,036,000,000	
	Amount	**As a % of Projected Payroll**
Increase in Employer Annual Cost		
Amortization Payment [1]	$348,100,000	2.71%
Total Increase in Employer Annual Cost	$348,100,000	2.71%

[1] First year amortization payment. 20-year amortization period, paid in part by the Commonwealth and in part by the school districts and other educational employers. Amortization payments cease after 20 years.

State Employees' Retirement System

	Amount	
Increase in Unfunded Actuarial Accrued Liability	$1,566,900,000	
	Amount	**As a % of Projected Payroll**
Increase in Employer Annual Cost		
Amortization Payment [1]	$165,600,000	2.90%
Total Increase in Employer Annual Cost	$165,600,000	2.90%

[1] First year amortization payment. 20-year amortization period. Amortization payments cease after 20 years.

Multiple Service Election Window

The Commission's consulting actuary has reviewed the multiple service election component of the bill and determined that because SERS is unable to identify the active members of SERS who may be eligible to elect multiple service membership under the bill, no reliable actuarial cost estimate can be made. Any actuarial cost impact resulting from implementation of the multiple service election window will be dependent upon both the number of eligible members who actually elect multiple service and the individual demographics (credited service, payroll, etc.) of those members. SERS would experience an increase in actuarial cost to the extent that the additional service credit resulting from the election of multiple service may permit an affected member to become eligible for normal retirement benefits earlier than would otherwise be the case or may enable a multiple service member to qualify for future early retirement incentives or other collateral benefits. PSERS would also experience an increase in actuarial cost because an affected member's benefit would normally be calculated using a higher final average salary and possibly a higher benefit accrual rate. Additionally, PSERS would be required to transfer to SERS the full amount required to fund the PSERS component of an affected multiple service member's benefit at the time of the member's retirement rather than paying the benefit over the course of the member's remaining retired lifetime.

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations.

Appropriateness of Postretirement Adjustment. Generally, increasing the pension benefits of members during the course of retirement in order to offset erosion in the purchasing power of the pension benefit due to the effects of inflation is a common practice in the public sector. The General Assembly and the Governor must determine whether the postretirement adjustments proposed in the bill are appropriate given the cumulative effect of previous COLAs combined with changes in the cost of living that have been experienced in recent years.

COLA Eligibility Criteria. The language of the bill would have the effect of including as eligible for the COLA those annuitants who, while active members, received the benefit enhancements provided by Act 9 of 2001. Depending on the class of service, these members received a significant benefit enhancement applicable to all periods of service (25% or 50%). The most recent COLA provided to members of PSERS and SERS under Act 38 of 2002, specifically excluded these members (membership classes AA, T-D and D-4) from COLA eligibility. The General Assembly and the Governor must determine whether the postretirement adjustments provided by the bill are appropriate for this group of annuitants.

Impact on Future Employer Contribution Rates. Because its implementation represents a change in the benefit provisions of the Systems, the costs of providing the ad hoc COLA provided by the bill must be added to the unfunded accrued liability of the respective Systems and funded prospectively by amortization payments over a 20-year period rather than the 10-year amortization period currently required by law. The additional liability resulting from enactment of the COLA will necessitate increased employer contributions to the Systems by the Commonwealth and public school employers. The General Assembly and the Governor must determine whether the increased employer contribution requirements resulting from the bill are appropriate and acceptable at this time.

Delayed Funding Commencement. The bill would mandate COLA payments for eligible annuitants of both PSERS and SERS beginning with the first monthly annuity payments after July 1, 2008, but would delay the commencement of funding for those benefits until July 1, 2009. Ideally, funding of the COLAs should commence at the same time as commencement of the increased benefit payments. Delayed funding generally serves only to increase the cost of providing the benefit enhancement. The delayed commencement of funding may be justified in the case of PSERS in order to permit public school districts and other educational employers to have adequate time to budget for the additional contributions that will be required to fund the benefit increase. However, the need to delay funding of the Commonwealth's portion of the required contributions to PSERS and the Commonwealth's contributions to SERS is unclear.

Absence of Need Determination Factor. Change in the Consumer Price Index (CPI) during an applicable period of retirement is the predominate basis for determining the amount of COLAs provided in public employee retirement plans. The bill does not appear to take into account an appropriate need factor based upon change in the CPI and the cumulative effects of past COLAs on the annuity payments of affected retirees.

Inter-System Parity (COLAs). Historically, the General Assembly has engaged in the practice of providing substantially similar benefits to both State and public school employees. The COLA proposal in the bill conforms to this trend by providing a COLA to retired members of both Systems.

Inter-System Parity (Multiple Service Election). Historically, the General Assembly has engaged in the practice of providing substantially similar benefits to both State and public school employees. The ability to elect multiple service membership is a benefit entitlement currently afforded to eligible active members of both PSERS and SERS. Because the bill would provide a multiple service election window applicable to eligible active members of SERS only, the proposal in the bill does not conform to this trend.

Conformance with Policy Guidelines. In response to Senate Resolution 103 (1999 Session), the Public Employee Retirement Commission released a report entitled *Funding Cost-of-Living Adjustments* in November 2000. The bill conforms to some and does not conform to other of the Commission's recommendations in the report with respect to the funding of ad hoc cost-of-living adjustments.

> *General Funding Approach.* Both the citizens and the policymakers of the Commonwealth benefit when the costs of any proposed benefit modification in a public employee retirement plan are funded in a straightforward manner. The Commonwealth has used a direct funding approach consistently since the initial ad hoc cost-of-living adjustment was implemented in 1968. An ad hoc cost-of-living adjustment is a modification in the benefit provisions of the Commonwealth's statewide retirement plans that has a definite, determinable cost. Utilization of a direct funding approach is necessary to provide a discernable relationship between the costs incurred in implementing an ad hoc cost-of-living adjustment and the increased funding requirements attributable to those costs. The bill appears to permit a direct funding approach for the liabilities incurred in the provision of the COLA.
>
> *Amortization Period.* The bill does not retain the 10-year level-dollar amortization approach recommended by the Commission and currently utilized by both PSERS and SERS for the funding of future COLA liabilities. Instead, the bill would increase the level-dollar amortization period from 10 years to 20 years. The use of a shorter amortization period is generally desirable because it reduces the interval between

the point in time when the liability is incurred and the point in time when the liability is funded and thereby reduces the degree of inter-generational cost transfer. The use of a shorter amortization period reduces the total amount of the amortization payments required to fund the liability, and limits the potential for compounded amortization payments attributable to multiple cost-of-living adjustments.

Partial Pre-funding of COLA Liabilities. Senate Resolution Number 103 (1999 Session) declared that the General Assembly is concerned with funding cost-of-living adjustments in the most economical manner, and efficiency in governmental operations is viewed as an appropriate objective by the citizens of the Commonwealth. In its report, the Commission recommended that the SERS and PSERS Codes be amended to provide a specified percentage of payroll contribution to be included in the annual determinations of the employer contribution rates as a means to provide advance direct funding for future COLAs and that the resulting contributions be placed in restricted accounts and used to partially pre-fund the liabilities of future cost-of-living adjustments. The systematic accumulation of monies within SERS and PSERS dedicated to reduce the unfunded liabilities incurred in the provision of future cost-of-living adjustments is a reasonable mechanism to achieve modified advance direct funding. The bill contains no provision for the partial pre-funding of future COLA liabilities.

Dissimilar Policy Objectives. The objective of a welfare postretirement adjustment is to address inadequacies in subsistence level retirement benefits caused by changes in compensation and other standard-of-living factors over an extended period of retirement. The objective of a cost-of-living postretirement adjustment is to address the incremental erosion of the purchasing power of retirement benefits caused primarily by inflation. Although the Commonwealth has not provided specific welfare postretirement adjustments, the last four cost-of-living postretirement adjustments (2002/03, 1998, 1994, 1989) that it has implemented have included provisions to provide long-term retirees significantly larger increases than short-term retirees. These provisions were initiated as a means of assisting long-term retirees receiving very low retirement benefits. Although targeting long-term retirees for higher benefits within a cost-of-living adjustment is one way to address the diminishment of the relative value of retirement benefits caused by changes in compensation and other standard-of-living factors over time, the practice may not be the most appropriate method within the context of a cost-of-living postretirement adjustment due to the dissimilar dual policy objectives involved.

COMMISSION RECOMMENDATIONS

On May 22, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2084, Printer's Number 3689, was re-referred to the House Appropriations Committee on May 6, 2008.

Bill ID: Amendment Number 06997 and 06998 to House Bill Number 2084, Printer's Number 3689

System: Public School Employees' Retirement System and State Employees' Retirement System

Subject: "13th Check" Conditional Postretirement Adjustments

SYNOPSIS

Amendment Numbers 06997 and 06998 to House Bill Number 2084, Printer's Number 3689, would amend the Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) to provide for a type of postretirement adjustment payable in the form of additional monthly annuity payments, known in the public pension community as a "13th check," to annuitants of both the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS) in any fiscal year in which the rate of investment return averaged over the most recently completed five-year period reaches a particular threshold. In the case of Amendment Number 06997, the investment return threshold is 15 percent. Amendment Number 06998 is nearly identical to Amendment Number 06997, except the investment return threshold is 10 percent.

DISCUSSION

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer, defined benefit retirement systems. The designated purposes of the Public School Employees' Retirement System and the State Employees' Retirement System (Systems) are to provide retirement allowances and other benefits, including disability and death benefits to public school and State employees.

Membership in the Systems is mandatory for most school and State employees. Certain other employees are not required but are given the option to participate. As of June 30, 2007, PSERS had 264,023 active members and 168,026 annuitants and beneficiaries. As of December 31, 2007, SERS had 109,610 active members and 107,130 annuitants and beneficiaries.

Generally, the annual retirement benefit for most members of SERS (Class AA) and PSERS (Class T-D) is the product of 2.5 percent multiplied by the member's years of accumulated service credit, multiplied by the member's final average (highest three years) salary.

Under the Public School Employees' Retirement Code, superannuation or normal retirement age is age 62 with at least one full year of service, age 60 with 30 or more years of service, or any age with 35 years of service. Under the State Employees' Retirement Code, superannuation or normal retirement age for most members is age 60 with three years of service or any age with 35 years of service, while age 50 is the normal retirement age for members of the General Assembly and certain public safety employees.

One commonly accepted goal of a public employee retirement system is to provide a retirement benefit that is adequate at the time of retirement. Therefore, the provision of cost-of-living postretirement adjustments to ensure the adequacy of the member's benefit throughout retirement represents a logical extension of that goal. In the absence of cost-of-living adjustments, the purchasing power of retirement benefits is diminished over time due to the effects of inflation.

It has been the defacto policy of the Commonwealth to grant periodic ad hoc postretirement increases to PSERS and SERS annuitants to reflect part of the increase in the cost-of-living. These ad hoc postretirement adjustments have been granted roughly every five years during the period from 1967-68 to 2003. Historically, the amounts of these cost-of-living adjustments have been roughly equivalent to one-half to two-thirds of the increase over the applicable period in the Consumer Price Index for all Urban Consumers (CPI-U), which is calculated by the Bureau of Labor Statistics of the United States Department of Labor and which is a frequently used measure of changes in the cost of living nationally.

The additional costs associated with the provision of a cost-of-living adjustment are normally added to the unfunded actuarial accrued liability of the affected retirement system and funded through amortization payments. Depending upon when they were enacted, previous cost-of-living adjustments were funded on a 20-year level dollar, 20-year level percentage, or 10-year level dollar basis. Under current law, all future cost-of-living adjustments must be funded over a 10-year period using level-dollar amortization contributions.

Under both Amendment Number 06997 and 06998, a 13^{th} check postretirement adjustment would be payable to eligible annuitants of both PSERS and SERS in any fiscal year in which the rate of investment return for the applicable retirement fund, averaged over the most recently completed five-year period, reached a particular threshold. In the case of Amendment Number 06997, the investment return threshold is 15 percent, and in the case of Amendment Number 06998, the investment return threshold is 10 percent. The amendments do not specify whether the investment returns are to be determined based on the market value of assets or the actuarial value of assets.

The amendments mandate that the amount of the 13^{th} check payment shall be equal to the monthly annuity payment being received by an eligible annuitant on July 1 of the applicable fiscal year. The 13^{th} check must be paid by the June 30 after the postretirement adjustment is deemed to be authorized, based upon attainment of the applicable investment performance threshold.

Under both amendments, annuitants eligible to receive the 13^{th} check postretirement adjustment are those annuitants who are receiving a superannuation or disability annuity on July 1 of the fiscal year in which the 13^{th} check is scheduled to be paid and who retired prior to the July 2 of the fiscal year prior to the fiscal year in which the postretirement adjustment is to be paid.

Any 13^{th} checks payable to members who retire on a withdrawal annuity will not commence until the July 1 coincident with or following attainment of the annuitant's superannuation date. The postretirement adjustments would also not be provided to the beneficiary or survivor annuitant of a member who died before the July 1 of the fiscal year in which the supplement is scheduled to be paid.

Under the amendments, any member who received the benefit enhancements provided by Act 9 of 2001, specifically those members with service credit in membership Class T-D, Class D-4 or Class AA, would be ineligible to receive any future 13^{th} check postretirement adjustment.

The amendments require that the cost attributable to the payment of a future 13^{th} check postretirement adjustment is to be funded through four equal quarterly installments in the fiscal year following the calendar year in which the postretirement adjustment is paid.

The Commission's consulting actuary has reviewed the amendments and actuarial cost estimates provided by the actuaries for PSERS and SERS.

The amendments specify that the additional liability for the 13th checks are to be funded in equal quarterly installments over the 12-month fiscal year next following the calendar year of payment.

The actuaries for PSERS and SERS have provided estimates of the amount of 13th checks that would be payable in June 2009 in the event either amendment was enacted effective for the 2008-9 fiscal year. The estimates represent the cost of a 13th check disbursal if one were payable in June 2009 based on investment performance from July 2003 through June 2008. These estimates are summarized in the following table.

	PSERS	SERS
13th check payable June 2009	$155.0 million	$72.0 million
Quarterly contributions payable FY 2010-11	$44.2 million	$20.5 million
Total Contributions	$176.8 million	$82.0 million
Estimated Payroll FY 2010-11	$13,226.9 million	$5,900.0 million
Contributions as a % of payroll	1.34%	1.39%

To estimate the likely future cost of the amendments over time, it is necessary to also estimate the likelihood that investment returns will be adequate to trigger the 13th check, that is, the likelihood that the returns over the preceding five years: 1) will exceed 15% in the case of Amendment Number 06997; or, 2) will exceed 10% in the case of Amendment Number 06998.

The probability of this occurring over the 5-year periods ending 2008 through 2012 will be affected by actual past returns. The following table summarizes the annualized rate of return needed subsequent to June 2007 in order to achieve the 15% and 10% thresholds for PSERS based on the reported returns through June 2007. Past returns for SERS on a July to June fiscal year basis were not available.

Annualized Returns Needed Subsequent to June 2007 to Achieve Indicated Threshold for PSERS

	PSERS	
5-Year Period Ending June	15% Threshold	10% Threshold
2008	5.03%	(15.90)%
2009	12.13	0.33
2010	12.38	4.36
2011	13.11	6.99

As indicated above, PSERS actual annualized investment return would need to be a positive 5.03% or higher during fiscal year 2007-8 in order to achieve the 15% threshold over the 5-year period ending June 2008, or a negative 15.9% or higher during that year to achieve the 10% threshold. Through December 31, 2007, PSERS reported actual returns of 2.96% in fiscal year 2007-8.

Looking forward beyond the end of FY 2010-11, the Commission's consulting actuary projected the probability of triggering 13th check payments in the period beyond FY 2010-11 by assuming that the expected annualized return on PSERS and SERS assets will be 8.5%, (which is the current actuarially assumed rate of investment return for PSERS), and that the standard deviation of the annual returns will be between 10% and 12%. The Commission's consulting actuary has advised that these are reasonable assumptions and are roughly consistent with the capital market assumptions used by PSERS and SERS to develop their investment policies. Based on these assumptions, the Commission's consulting actuary estimates that there is roughly a 10% chance that, over a future 5-year period, the annualized investment return will exceed 15%, and roughly a 40% chance that it will exceed 10%.

If the estimated cost of a single year's 13th check payment as a percentage of payroll (this assumes that the cost of a 13th check payable in June 2009 is representative of the cost of a 13th check in future years) is combined with the estimate of the probability that PSERS and SERS annualized investment returns will exceed 15% and 10% over a future 5-year period, a reasonable estimate of the potential future cost of each of the amendments can be obtained. These estimates are summarized in the following table.

	AMENDMENT NO. 06997		**AMENDMENT NO. 06998**	
	PSERS	**SERS**	**PSERS**	**SERS**
Cost of 13th check as a percent of payroll	1.34%	1.39%	1.34%	1.39%
Estimated probability that threshold return will be achieved	10%	10%	40%	40%
Estimated average cost of amendment over time as a percent of payroll	0.13%	0.14%	0.54%	0.56%

POLICY CONSIDERATIONS

In reviewing the bill as amended, the Commission identified the following policy considerations.

<u>Fundamental Policy Change</u>. Historically, the General Assembly has chosen to retain authority in the timing and amount of postretirement adjustments provided to retirees of the two statewide retirement systems by granting periodic ad hoc cost-of-living adjustments. The amendments propose to provide postretirement adjustments in the form of periodic "13th check" payments that would be issued to eligible annuitants automatically following the attainment of certain investment performance thresholds. Therefore, the amendments would have the effect of transferring authority for determining the amount and timing of future postretirement benefit changes from the General Assembly to the Boards of the respective retirement systems. The General Assembly must consider whether this policy change is an appropriate delegation of legislative authority.

Potential for Distortion of Fiduciary Duties. The trustees and staff of PSERS and SERS have a statutorily mandated fiduciary obligation that includes a duty of loyalty to manage the fund for the exclusive benefit of the membership as a whole, and a duty of prudence that encompasses an obligation to act in an economically rational way. This obligation has resulted in the development of investment policies that have the goal of keeping PSERS and SERS well-funded for the long-term benefit of all members (active as well as annuitant members). Because PSERS and SERS are defined benefit retirement systems, members neither directly benefit nor suffer financially if Fund performance is strong or weak during a given period of time. The amendments have the potential to distort this fiduciary obligation by causing the Boards to place priority on achieving the investment performance necessary to trigger the 13th check payments, even if doing so may not be in the best long-term interest of the Funds or the members.

Federal Tax Qualification Implications. Both PSERS and SERS are subject to certain requirements of the Internal Revenue Code (IRC) in order to maintain their status as tax-qualified pension plans. Both IRC Sections 401(a)(9) and 415 place significant restrictions on benefit increases provided subsequent to retirement, including 13th check postretirement supplements. While a detailed investigation of the tax qualification issues surrounding 13th check payments is beyond the scope of the Commission's analysis of the amendments, such an investigation should be undertaken by qualified tax counsel prior to enactment of either amendment. Given recent communications by the IRS to the public pension community indicating that increased scrutiny of governmental plans is to be expected in the near future, it is imperative that the detailed operation of the amendments be made compliant with IRC regulations.

Absence of Need Determination Factor. To date, the change in the Consumer Price Index (CPI) during an applicable period of retirement has been the predominate basis for determining the amount of postretirement benefit augmentation provided in public employee retirement plans. The amendments would replace this measure of need with sporadic future supplemental benefit payments, the timing and amounts of which would be solely dependent upon the attainment of investment return thresholds and would likely bear little or no relationship to actual changes in the cost of living.

Potential for Benefit Disparity. Historically, the General Assembly has sought to provide identical or nearly identical benefits to members of PSERS and SERS. The amendments propose to provide future postretirement benefit adjustments based solely upon the attainment of certain investment performance criteria. There exists the possibility that the investments of one of the two retirement Funds may significantly outperform the other over a given five-year period. This could result in a situation in which the annuitants of one system receive a 13th check supplement, while annuitants of the other system receive nothing. Charging the Boards of PSERS and SERS with the task of determining and providing automatic 13th check postretirement payments to retirees, based solely upon the investment performance of each Fund, could have the result of creating significant benefit disparities between annuitant members of PSERS and SERS.

Inequitable Treatment of Long-Term Annuitants. Historically, the General Assembly has enacted postretirement adjustments that provided proportionately larger benefit increases to long-term retirees. This policy of weighting postretirement adjustments in favor of long-term retirees is premised on the assumption that longer-term retirees are more in need of such benefit increases due to the greater effects of changes in the cost of living on the relative buying power of these members' annuities over time. The amendments would essentially reverse this policy by providing postretirement adjustments in the form of additional monthly annuity payments (13th checks) rather than postretirement adjustments that are based on changes in the cost-of-living. Because more recent retirees will generally be entitled to higher monthly benefit payments (by virtue of higher final average salaries) in most cases, this arrangement would tend to result in more recent retirees receiving proportionally larger 13th check payments in comparison with long-term retirees. The public policy rationale for implementing such an arrangement is unclear.

Funding Approach. Under current law, the additional liability associated with the payment of supplemental annuities would be added to the unfunded actuarial accrued liability of the affected retirement system (PSERS or SERS) and amortized over a 10- year period through level-dollar amortization payments. However, the amendments mandate that the cost attributable to the payment of a future 13th check is to be funded in a single year through four equal quarterly installments paid in the fiscal year following the calendar year in which the postretirement adjustment is paid. Because the amendments preclude the option of amortizing the liability resulting from payment of a future 13th check, the funding requirement contained in the amendments would trigger an immediate increase in employer contribution requirements in the specified year equivalent to the full amount of the 13th check payment. The feasibility of compelling quarterly payments from public school and Commonwealth employers is unclear. If the amendments were enacted, additional technical amendments to the PSERS and SERS Codes would likely be required to empower the Boards of the two systems with specific authority to obtain employer contributions on a quarterly basis. Additionally, if either amendment were enacted, the 13th check would be payable June 30 but funding for this supplemental payment would not begin until one year later. The affected retirement system would be required to pay a one-time payment one year prior to receiving any contributions to finance the payment to annuitants. It would be desirable to permit school employers adequate time to budget for the additional contributions to fund the 13th check payment; however, it seems likely that PSERS could determine the adjustment to employer contribution rates early enough to include the cost of the 13th check in the employer contribution rate for the fiscal year immediately following the payment of the 13th check. Moreover, it is not apparent why a one-year delay in funding would be appropriate for the Commonwealth's portion of the PSERS contribution requirements or for the Commonwealth's contributions to SERS.

Exclusion of Class T-D, D-4 and AA Members. The amendments would exclude from eligibility for all future 13th check payments any annuitant with credited service in Class T-D, D-4 or AA, presumably because these members received the benefit enhancements provided by Act 9 of 2001. However, nearly all post-Act 9 entrants to SERS enter the system as members of Class AA, and all post-Act 9 members of PSERS enter that system as Class T-D members. Eventually, nearly all future annuitants of SERS will be Class AA members and all PSERS annuitants will be Class T-D members. In time, the amendments would have the effect of guaranteeing that nearly all future annuitants of both systems would be ineligible to receive future 13th check payments, rendering the 13th check provision inoperable for nearly all but a small minority of members in special membership classes. The public pension policy rationale for implementing such a provision is not apparent.

Ambiguous Technical Design Features. In reviewing the amendments, the Commission staff noted the following design features that appeared to be either technically flawed or ambiguous in nature. The staff recommends that the sponsor of the amendments modify the amendments to clarify the operational intent of the provisions described below.

> *Five-year Average of Investment Returns*. There is some ambiguity in the amendments concerning whether the five-year period over which the investment returns are to be averaged (a) ends prior to the fiscal year in which the 13th check is to be paid or (b) includes that fiscal year. The Commission staff believes that it is the intent of the amendments for the five-year period to end prior to the fiscal

year in which the 13th check is to be paid because it would not otherwise be possible to calculate the average annual rate of investment returns prior to the end of the fiscal year. In practice, several weeks or more following the end of the fiscal year are normally required to obtain and verify the investment return data necessary to calculate that figure. It would appear, therefore, that the amendments intended a delay of one full year between the end of the five-year period and the time when the 13th checks are to be paid. However, the amendments should be modified to clarify this provision.

SERS "Fiscal Year." The amendments require measurement of both SERS and PSERS annual investment performance based on a July to June fiscal year. PSERS measures its annual investment performance on a fiscal year rather than a calendar year basis; therefore, the July to June fiscal year required by the amendments is appropriate for PSERS. However, SERS measures its annual investment performance on a January 1 to December 31 calendar year basis. Interpreted strictly, the amendments would seem to require the determination of whether SERS is to pay a 13th check to be made on the basis of performance results that have not been audited and possibly may not be entirely accurate. The amendments should be modified to clarify whether the fiscal year specified for purposes of determining the SERS 13th checks is to be (a) the July/June year, or (b) SERS' fiscal year for financial statement purposes.

Average Annual Rate of Return. The amendments refer to the "average annual" rate of investment return of the Fund over the previous five-year period. This would normally mean the arithmetic average of the annual returns over the five years. It would be preferable to use the term "annualized" instead of "annual" rate of investment return over the five years, since that requirement would (a) reflect the underlying rate at which assets are growing on a compounded basis and (b) would be consistent with application of each retirement system's actuarial investment return assumption.

Market Value/Actuarial Value of Assets. The amendments are silent on whether investment returns are to be based on the market value of assets or the actuarial value of assets. If the actuarial value of assets is to be used, SERS would be required to perform additional calculations, because the actuarial value of assets for SERS are currently determined only once per year as of each December 31. In addition, because the actuarial value of assets smooths investment gains and losses, the investment returns on the actuarial value of assets would be dampened when compared to the investment returns on the market value of assets. The amendment should be modified to specify whether the market value or actuarial value of assets is to be used.

Terms and Conditions of Annuity. The staff of the Commission believes that the amendments were intended to authorize the payment of a "one-time" 13th check payment to eligible annuitants following attainment of the specified investment performance threshold. However, the amendments do not specifically state this intention. Instead, the amendments require that, "*The supplemental annuity provided under this section shall be payable under the same terms and conditions as provided under the option plan in effect as of July 1 of the fiscal year during which the supplemental annuity is scheduled to be paid."* The language describing "terms and conditions" in both the PSERS and SERS Codes is a reference to the form of annuity payment that is made to the member (maximum single life annuity, Option 1, Option 2 and 3 joint and survivor annuity, etc.) and to which the member is generally entitled to receive for life. As a consequence, the potential exists for this provision to be interpreted in the same manner as previous "supplemental annuities," meaning a permanent benefit enhancement, thus requiring the 13th check to be paid each year and to which may be added additional 13th check payments as the investment return threshold is repeatedly satisfied in the future. The staff believes that such an interpretation was not, however, the intent of the sponsor or the amendments. To preclude such an interpretation, the amendment should be modified to remove references to the 13th check as a "supplemental annuity" payable under the "same terms and conditions" as the option elected by the member and to further clarify that any 13th check payments are to be treated as single events conditioned upon the attainment of the specified investment performance threshold.

COMMISSION RECOMMENDATION

On June 25, 2008, the Commission voted to attach the actuarial note to the amendments, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2084, Printer's Number 3689, was re-referred to the House Appropriations Committee on May 6, 2008.

Bill ID: Amendment Number 07040 to
House Bill Number 2084, Printer's Number 3689

System: Public School Employees' Retirement System and
State Employees' Retirement System

Subject: Retirement Option 5 Automatic Postretirement Cost-of-Living Adjustments

SYNOPSIS

Amendment Number 07040 to House Bill Number 2084, Printer's Number 3689, would amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code by creating an additional member retirement option, known as retirement Option 5, applicable to members of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS) who are eligible to retire on a superannuation or a withdrawal annuity on or after July 1, 2008. Option 5 would provide automatic annual postretirement cost-of-living adjustments (COLAs) to members who elect Option 5, which would require affected members to forego withdrawal of their accumulated deductions (member contributions) from the applicable retirement system under retirement Option 4, and instead elect to leave their accumulated deductions in the retirement system and accept an actuarially reduced retirement benefit in return for the entitlement to a guaranteed annual COLA.

DISCUSSION

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer, defined benefit retirement systems. The designated purposes of the Public School Employees' Retirement System and the State Employees' Retirement System (Systems) are to provide retirement allowances and other benefits, including disability and death benefits to public school and State employees.

Membership in the Systems is mandatory for most school and State employees. Certain other employees are not required but are given the option to participate. As of June 30, 2007, PSERS had 264,023 active members and 168,026 annuitants and beneficiaries. As of December 31, 2007, SERS had 109,610 active members and 107,130 annuitants and beneficiaries.

Generally, the annual retirement benefit for most members of SERS (Class AA) and PSERS (Class T-D) is the product of 2.5 percent multiplied by the member's years of accumulated service credit, multiplied by the member's final average (highest three years) salary.

Under the Public School Employees' Retirement Code, superannuation or normal retirement age is age 62 with at least one full year of service, age 60 with 30 or more years of service, or any age with 35 years of service. Under the State Employees' Retirement Code, superannuation or normal retirement age for most members is age 60 with three years of service or any age with 35 years of service, while age 50 is the normal retirement age for members of the General Assembly and certain public safety employees.

One commonly accepted goal of a public employee retirement system is to provide a retirement benefit that is adequate at the time of retirement. Therefore, the provision of cost-of-living postretirement adjustments to ensure the adequacy of the member's benefit throughout retirement represents a logical extension of that goal. In the absence of cost-of-living adjustments, the purchasing power of retirement benefits is diminished over time due to the effects of inflation.

It has been the defacto policy of the Commonwealth to grant periodic ad hoc postretirement increases to PSERS and SERS annuitants to reflect part of the increase in the cost-of-living. These ad hoc postretirement adjustments have been granted roughly every five years during the period from 1967-68 to 2003. Historically, the amounts of these cost-of-living adjustments have been roughly equivalent to one-half to two-thirds of the increase over the applicable period in the Consumer Price Index for all Urban Consumers (CPI-U), which is calculated by the Bureau of Labor Statistics of the United States Department of Labor and which is a frequently used measure of changes in the cost of living nationally.

Granting a cost-of-living adjustment involves undertaking the functional equivalent of a long-term debt. The additional costs associated with the provision of a cost-of-living adjustment are added to the unfunded actuarial accrued liability of the retirement system and funded prospectively through amortization payments. Depending upon when they were enacted, previous cost-of-living adjustments were funded on a 20-year level dollar, 20-year level percentage, or 10-year level dollar basis. Under current law, all future cost-of-living adjustments must be funded over a 10-year period using level dollar amortization contributions.

Members' Retirement Options

The maximum single life annuity is the basic retirement benefit entitlement for members of PSERS and SERS. The maximum single life annuity provides the largest monthly pension payment to which an eligible member is entitled for the member's retired lifetime. When a member who has elected to receive benefit payments in the form of the maximum single life annuity dies, that member's designated beneficiaries are entitled to receive a death benefit in an amount equal to the member's total accumulated deductions, less any accumulated deductions withdrawn by the member at retirement and any retirement benefit payments that the member received prior to death. The member's "accumulated deductions" are the total of the member's employee contributions to the retirement system that have accrued over the member's working lifetime, plus accumulated interest at the statutory rate of four percent. If the total amount of benefit payments the member received prior to death exceeds that member's accumulated deductions, no death benefit will remain to be paid to the member's designated beneficiaries.

In addition to the maximum single life annuity, the retirement Codes of both PSERS and SERS provide additional member options intended to provide members with flexibility in deciding the manner in which members' benefits are disbursed and to ensure that members who choose to do so have the ability to provide a reliable benefit stream to their designated survivor beneficiaries. The following summarizes the four currently available retirement benefit disbursal options.

> *Option 1*: A member electing retirement Option 1 would be entitled to receive a monthly benefit payment that is less than the maximum single life annuity. The member's designated beneficiaries would be entitled to a death benefit equal to the present value of the member's benefit, less the amount of pension payments you received to the date of death. If the total amount of retirement benefit payments received exceeds the amount of the member's present value, no death benefit will remain to be paid.
>
> *Option 2*: A member electing retirement Option 2, would also receive a reduced monthly benefit because benefits are provided for two people. Upon the member's death, the member's designated survivor receives a monthly benefit payment identical to that which the member received for the survivor's remaining lifetime. The Option 2 benefit is computed using both the member's age and the age of the designated survivor at the time of the member's retirement. The younger the member's designated survivor, the greater will be the actuarial reduction in the member's monthly benefit.

Option 3: As with Option 2, Option 3 also provides the member with a reduced monthly benefit, because benefits are provided for two persons. Upon the member's death, the member's designated survivor receives a benefit equal to 50% of the member's monthly benefit for the survivor's remaining lifetime. The Option 3 benefit is computed using both the members age and the age of the member's designated survivor at the time of the member's retirement. The younger the member's designated survivor, the greater will be the actuarial reduction in the member's monthly benefit.

Option 4: In addition to the maximum single life annuity and Options 1, 2 and 3, members of PSERS and SERS have a fourth retirement option, known as Option 4. Within limitations and subject to approval by the Boards of the Systems, Option 4 permits a member to develop a payment plan of the member's own design. Any plan the member designs must be determined by the Systems' Boards to be actuarially sound and consist of level monthly payments. Annuities for designated survivor beneficiaries may not be greater than one and one-half times the annuity payable to the member. Option 4 also permits a retiring member to withdraw all or a portion of the member's accumulated deductions. As noted previously, the member's "accumulated deductions" are the total of the member's employee contributions to the retirement system that have accrued over the member's working lifetime, plus interest at the statutory rate of four percent. A member may elect to receive this withdrawal in one lump sum or in up to four installment payments. The installments will continue to earn interest at the statutory rate of four percent per year until they are paid to the member. A member who elects to withdraw his or her accumulated deductions is entitled to a lifetime monthly pension benefit that is smaller than under either the maximum single life annuity or Options 1 thru 3, because the benefit will be computed on the present value of the member's benefit entitlement less the amount of the accumulated deductions that were withdrawn.

Amendment Number 07040 would provide a fifth retirement option for members of both PSERS and SERS. "Option 5," as it is called, would provide automatic annual postretirement cost-of-living adjustments (COLAs) to members who elect the option. In return for the right to receive the guaranteed annual COLA, a member who elects Option 5 must agree to leave the member's accumulated deductions in the retirement system, forego the right to withdraw the accumulated deductions under retirement Option 4, and accept an actuarially reduced monthly benefit payment stream for life.

Beginning July 1, 2009, and each July 1 thereafter, the amount of the automatic COLA would be the lesser of 3% or the percentage change in the Consumer Price Index for all Urban Consumers (CPI-U) for the Pennsylvania, New Jersey, Delaware and Maryland area, for the most recent 12-month period immediately prior to the date of the adjustment. This increase would be applied to the then current annuity amount. Therefore, the COLA is based on the member's actuarially reduced benefit, and is compounded. The first COLA would be effective on the July 1 coincident with or following the first anniversary of retirement, and subsequent COLAs would become effective each following July 1. COLAs for members who retire on a withdrawal annuity will not commence until the July 1 coincident with or following attainment of the annuitant's superannuation date.

The amendment requires that the Option 5 benefit be actuarially equivalent to the maximum single life annuity. The cost of providing an automatic COLA would be offset by the actuarially reduced initial benefit provided to the member under the option. In theory, an Option 5 annuitant would effectively be financing his or her own annual COLAs through the accumulated deductions remaining in the retirement system and by agreeing to accept an actuarial reduction in the initial retirement benefit amount. However, in practice, the Option 5 benefit will most likely not be actuarially equivalent on an individual basis. Under the amendment, the individual member's contributions and interest will not equal, other than by chance, the required amount to fund the specific level of COLA prescribed for a given individual member.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the amendment and the actuarial cost estimates provided by the actuaries of the respective retirement systems. The consulting actuary for PSERS has estimated that if all eligible retirees elect Option 5, and the current actuarial assumptions are realized, PSERS should not incur any gains or losses. The consulting actuary for SERS has estimated that the normal cost rate (which is based on new entrants into membership Class AA) would remain approximately the same if the amendment is enacted and all eligible retirees elect Option 5. The consulting actuary for SERS would need to perform further analysis to determine if the actuarial reduction, in aggregate, would be sufficient to fund the COLAs provided by the amendment and thus determine if the amendment would be truly cost neutral in the aggregate.

In preparing their actuarial cost estimates, the consulting actuaries for PSERS and SERS also assumed that all eligible retirees would elect Option 5. However, in the opinion of the Commission's consulting actuary, it is unlikely that all eligible members of both Systems would elect Option 5. Given the experience of both PSERS and SERS with respect to the popularity of Option 4 withdrawals (over 90 percent of eligible members elect to withdraw all or a portion of their accumulated deductions), and due to the large reduction in the initial monthly benefit resulting under Option 5, it seems unlikely that all retiring members would be willing to accept such a large immediate benefit reduction in return for a promise of future annual COLAs capped at three percent.

As the amendment is drafted, the actuarial reduction for the Option 5 automatic COLA benefit as interpreted by PSERS and SERS would be the same as if the member withdrew his or her accumulated deductions and interest under retirement Option 4. However, as the amendment is currently drafted, this reduction will not equal (except by coincidence) the actuarially equivalent reduction for the automatic COLA benefit on an individual member basis. (All other optional forms of benefit payment are actuarially equivalent to the maximum single life annuity on an individual member-by-member basis).

The amendment also requires that the actuary certify the Option 5 benefit to be actuarially equivalent to the maximum single life annuity. The Commission's consulting actuary believes that this requirement should supercede other language in the amendment suggesting an actuarial reduction as if the member withdrew his or her accumulated contributions under retirement Option 4. If the amendment is so interpreted, the amendment would extend the current treatment of all other optional forms to Option 5.

Because, in practice, the Option 5 benefit would most likely not be actuarially equivalent to the maximum single life annuity on an individual member basis, the Commission's consulting actuary has indicated that any actuarial costs resulting from the amendment would be dependent upon the number of members electing Option 5, the individual demographic characteristics of those members, and the actual COLA increases.

POLICY CONSIDERATIONS

In reviewing the bill as amended, the Commission identified the following policy considerations:

> Fundamental Policy Change. Historically, the General Assembly has chosen to retain authority in the timing and amount of COLAs provided to retirees of PSERS and SERS by granting periodic ad hoc COLAs. The amendment proposes to implement automatic, annual COLAs and to transfer authority for determining the amount of these future COLAs from the General Assembly to the Boards of the respective retirement systems. The General

Assembly must consider whether this policy change is an appropriate delegation of legislative authority.

Determination of Actuarial Equivalence. The amendment requires that the Option 5 benefit "*shall be certified by the actuary to be actuarially equivalent to the maximum single life annuity.*" However, the Option 5 benefit will not be actuarially equivalent on an individual member basis as are the other retirement options offered by PSERS and SERS, because these other retirement options are valued using a specific mortality table and interest rate. Under the amendment, the individual member's contributions and interest will most likely not equal, other than by chance, the required amount to fund the specific level of COLA prescribed for a given individual member (i.e., a full CPI COLA capped at three percent). Option 5 is tied to the member's contributions and interest which, in principle, could be the basis for determining an actuarially equivalent level of permanent COLA benefit; however, that is not what the amendment would provide. Therefore, the Systems' consulting actuaries will not be able to certify Option 5 as actuarially equivalent to the maximum single life annuity. If the General Assembly wishes to provide an optional form of payment with an automatic COLA, the amendment should be modified to clarify that the Option 5 benefit be actuarially equivalent to the maximum single life annuity on an individual member-by-member basis.

Potential for Adverse Selection. Because it is unlikely, except by chance, that an individual member's accumulated deduction and interest will precisely equal the amount required to fund the specific level of COLA for a given individual member, the Option 5 election may prove most attractive to those members whose accumulated deductions and interest would be insufficient to fund their Option 5 COLA. To the extent that affected individual members correctly ascertain that such an election is to their advantage, Option 5 elections may result in some anti-selection against PSERS and SERS. Therefore the potential exists for added costs to both PSERS and SERS due to member elections of Option 5 that result in an increase in individual benefit values that exceed the value of individual benefits foregone.

Utility of Option 5 Election. The ability of a retiring member to withdraw his or her accumulated deductions, with interest, is a significant and popular benefit afforded to members of both PSERS and SERS. According to the staff of both Systems, the utilization rate of Option 4 withdrawals currently exceeds 90%, meaning over 90% of eligible members elect to withdraw all or a portion of their accumulated deductions at retirement. Given the experience of both PSERS and SERS with respect to the popularity of Option 4 withdrawals, and due to the large reduction in the initial monthly benefit resulting under Option 5, it seems unlikely that many retiring members would be willing to accept an immediate reduction of such a magnitude in return for a promise of future annual COLAs capped at three percent. Therefore, the added utility of providing this additional member option (Option 5) appears to be somewhat questionable.

Potential Impact on Current Practice. It is a commonly accepted goal of public employee retirement systems to provide retirement benefits to plan members that are adequate at the time of retirement. Therefore, the provision of cost-of-living postretirement adjustments to ensure the adequacy of the members' benefits throughout retirement represents a logical extension of that goal. The impact of the amendment's enactment on the Commonwealth's defacto policy of providing COLAs to school and State retirees on an ad hoc basis is not clear, but potentially significant. A number of scenarios are possible. One possible outcome is that future ad hoc COLAs cease to be provided and that only Option 5 annuitants will receive COLAs as prescribed by the amendment. Alternatively, under certain economic conditions, such as a protracted period of high inflation, the General Assembly may deem it necessary to provide ad hoc COLAs to annuitants regardless of whether Option 5 was elected; a practice that would tend to greatly undermine the

POLICY CONSIDERATIONS (CONT'D)

desirability of Option 5 from the member's viewpoint. Ultimately, the Commonwealth's policy makers must weigh the relative merits and potential consequences of enacting the amendment.

COMMISSION RECOMMENDATION

On June 25, 2008, the Commission voted to attach the actuarial note to the bill as amended, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2084, Printer's Number 3689, was re-referred to the House Appropriations Committee on May 6, 2008.

Bill ID: House Bill Number 2084, Printer's Number 3689
as amended by Amendment Number 07093

System: Public School Employees' Retirement System and
State Employees' Retirement System

Subject: Ad Hoc Cost-of-Living Adjustments and Multiple Service Election

SYNOPSIS

House Bill Number 2084, Printer's Number 3689, would: 1) amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code to provide an ad hoc cost-of-living adjustment (COLA) (referred to as "supplemental annuities" in the governing statutes of the retirement systems) to annuitants of both the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS), commencing with the first monthly annuity payment after July 1, 2008; and 2) amend the State Employees' Retirement Code by opening a temporary "window" (beginning on the effective date of the bill and ending December 31, 2008) for members of SERS who have credited service in PSERS, were once eligible to elect multiple service membership, but who failed to elect multiple service membership within the current 365-day limit imposed by the SERS Code.

To be eligible for the COLA, superannuation and disability annuitants must be receiving an annuity on July 1, 2008, and have an effective date of retirement prior to July 2, 2007. Withdrawal annuitants will not be eligible to receive the COLA until the first day of July coincident with or following attainment of superannuation (normal retirement) age. The bill would also mandate a change in the amortization of the additional liabilities attributable to the COLA provided by the bill and all future COLAs from the currently mandated 10-year level-dollar amortization period to a 20-year level-dollar amortization period with funding commencing July 1, 2009.

Amendment Number 07093 would amend the bill to exclude from eligibility for the COLAs those annuitants who have credited service in membership classes AA, T-D or D-4.

DISCUSSION

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer, defined benefit retirement systems. The designated purposes of the Public School Employees' Retirement System and the State Employees' Retirement System (Systems) are to provide retirement allowances and other benefits, including disability and death benefits to public school and State employees.

Membership in the Systems is mandatory for most school and State employees. Certain other employees are not required but are given the option to participate. As of June 30, 2007, PSERS had 264,023 active members and 168,026 annuitants and beneficiaries. As of December 31, 2007, SERS had 109,610 active members and 107,130 annuitants and beneficiaries.

Under the Public School Employees' Retirement Code, superannuation or normal retirement age is age 62 with at least one full year of service, age 60 with 30 or more years of service, or any age with 35 years of service. Under the State Employees' Retirement Code, superannuation or normal retirement age for most members is age 60 with three years of service or any age with 35 years of service, while age 50 is the normal retirement age for members of the General Assembly and certain public safety employees. Temporary provisions of the Codes also have permitted members with 30 or more years of service to retire at any age and receive full retirement benefits with no benefit reduction for retiring prior to normal retirement age. The last such special early retirement provision expired June 30, 1999.

Postretirement Cost-of-Living Adjustments (COLAs)

In the operation of a defined benefit retirement system, a formula determines the retirement benefit that is payable at the time of retirement. If the employer determines that a change in the retirement benefit is warranted after retirement occurs, the benefit augmentation is termed a postretirement adjustment. Postretirement adjustments may be made for various reasons. In the Commission's November 2000 report entitled *Funding Cost-of-Living Adjustments*, three basic categories of postretirement adjustments were identified: remedial, welfare and cost-of-living. Remedial postretirement adjustments are used to correct an error in the retirement benefits provided to one group of retirees or to correct an inequity in the retirement benefits between two groups of retirees. Welfare postretirement adjustments are provided to remedy severe financial hardships experienced by long-term retirees or very short service retirees. Cost-of-living postretirement adjustments, or cost-of-living increases, are utilized to address erosion in the purchasing power of retirement benefits caused by inflation.

Cost-of-living postretirement adjustments in public employee retirement systems are granted for the purpose of maintaining the adequacy of retirement benefits after retirement occurs. In the absence of cost-of-living adjustments, the purchasing power of the retirement benefits is diminished over time due to the effects of inflation. Because one commonly accepted goal of a public employee retirement system is to provide a benefit at retirement that is adequate to meet the needs of the retirement system's retired members, the provision of cost-of-living adjustments to ensure the adequacy of the benefit throughout retirement represents a logical extension of this goal.

Cost-of-living adjustments may be provided automatically or on an ad hoc basis. Ad hoc COLAs may be desirable from an employer perspective because the finite nature of the costs and the discretion in the benefit amount provide the potential for the employer to match the costs to the available financing when implementing ad hoc COLAs. Because their implementation represents a change in the benefit provisions of the retirement system and because the precise amount of the benefit augmentations are not predetermined, ad hoc COLAs provide limited potential for the costs incurred to be prefunded. Instead, the costs of an ad hoc COLA are usually added to the unfunded accrued liability of the retirement system and funded by amortization payments. Since active members will receive no benefit from an ad hoc COLA, the amortization payments are generally made exclusively by the employer.

Historically, Commonwealth policymakers have employed a de facto policy of providing ad hoc cost-of-living adjustments to public employees. Since 1968, postretirement cost-of-living adjustments have been authorized by the Pennsylvania General Assembly for both PSERS and SERS retirees on an ad hoc basis approximately every four to six years, with the incurred unfunded actuarial accrued liabilities being amortized over a 20-year period. The passage of Act 9 of 2001 altered this amortization schedule. The Codes of both SERS and PSERS, as amended by Act 9 of 2001, now require that the unfunded liabilities attributable to COLAs be amortized over a 10-year period, with the amortization payments calculated on a level-dollar basis. The shorter 10-year amortization period is desirable because it serves to reduce the total amount of the required amortization payments associated with future COLAs, lessens the potential for the compounding of amortization payments attributable to multiple COLAs, and increases inter-generational equity by reducing the time elapsed between the service of the COLA recipients and the funding for the COLA benefits. The bill would change the current 10-year amortization period, requiring that the unfunded actuarial accrued liability resulting from the benefit increase be amortized through level-dollar payments over a period of 20 years beginning July 1, 2009.

Under the bill as amended, the amount of the COLA is based on the annuitant's most recent effective date of retirement. The total percentage increase payable to eligible annuitants of both Systems under the COLA is shown in the following table.

Most Recent Effective Date of Retirement	Percentage Increase
July 2, 2006 through July 1, 2007	2.67%
July 2, 2005 through July 1, 2006	4.01%
July 2, 2004 through July 1, 2005	5.85%
July 2, 2003 through July 1, 2004	7.67%
July 2, 2002 through July 1, 2003	8.75%
July 1, 2001 through July 1, 2002	9.15%
July 2, 1997 through June 30, 2001	10.00%
July 2, 1990 through July 1, 1997	15.00%
Prior to July 2, 1990	25.00%

Because cost-of-living postretirement adjustments are specifically utilized to address erosion in the purchasing power of retirement benefits caused by inflation, the determination of financial need is the central element in the design of a postretirement adjustment that is based upon changes in the cost of living. The potential measures of change in the cost of living include: the Consumer Price Index (CPI), the gross domestic product deflator, the employer cost index covering compensation rates in the civilian nonfarm economy, the average increase in compensation paid to all active employees of the applicable employer or the increase in compensation paid to a particular employment position.

The most widely used measure of the change in the cost of living for retirement benefit recipients has been the CPI, which is issued monthly by the Bureau of Labor Statistics of the United States Department of Labor. The CPI is a measure of the relative cost over time of a number of consumer goods and services and is the most widely accepted average measure of the effects of changes in the cost of living.

Recent COLAs granted by the General Assembly for PSERS and SERS annuitants have had the effect of replacing approximately 50% of the cumulative change in the CPI over the applicable period of time. In terms of the proposed percentage increases, the bill resembles the COLAs provided under Act 38 of 2002. As the following table illustrates, the increases proposed by the bill would, when combined with the cumulative effects of previous COLAs, provide cost-of-living increases for eligible annuitants that exceed 50% of the CPI.

Comparison of Cumulative Increase in CPI-U Since Retirement
with the Cumulative COLAs Granted
to PSERS and SERS Non-Act 9 Annuitants who Retired on July 1 [1]

Year of Retirement	Cumulative Increase in CPI-U to Mar. 2008	Cumulative COLAs prior to House Bill Number 2084			Cumulative COLAs after House Bill Number 2084		
		Actual COLA	% of CPI-U	Lost Purch-asing Power	Actual COLA	% of CPI-U	Lost Purch-asing Power
1985	98%	36%	37%	31%	70%	71%	14%
1986	95	36	38	30	70	73	13
1987	88	35	40	28	69	79	10
1988	80	31	38	28	63	79	9
1989	72	25	35	27	56	79	9
1990	64	22	35	25	53	83	7
1991	57	22	38	22	40	70	11
1992	52	18	34	23	35	68	11
1993	48	16	33	22	33	70	10
1994	44	14	33	20	32	72	9
1995	40	11	28	20	28	70	9
1996	36	10	26	19	26	72	7
1997	33	8	23	19	24	72	7
1998	31	8	24	18	18	59	10
1999	28	6	23	17	17	60	9
2000	24	5	21	15	15	65	7
2001	20	3	15	14	13	62	6
2002	19	2	12	14	12	63	6
2003	16	0	0	14	9	54	6
2004	13	0	0	11	8	60	4
2005	9	0	0	8	6	63	3
2006	5	0	0	5	4	81	1
2007	3	0	0	2	3	106	0

[1] For the January 1, 1989, supplemental annuities, the retiree was assumed to have 30 years of service.

Multiple Service

Multiple service membership involves the combining of PSERS service and SERS service for retirement credit purposes. An individual with prior service credit in one of the retirement systems who, due to a change in employment status, becomes a member of the other retirement system may elect to become a multiple service member.

If an individual elects multiple service membership, the individual receives credit for each type of service in the respective retirement system. An individual cannot receive a combined total of service credit in the two systems of more than one year for service in any one calendar year. The individual's record of service, contributions, and interest in each system remains in that system until the individual applies for a refund or retirement. When the individual applies for retirement, each system separately calculates the individual's retirement annuity. Each retirement system's annuity is calculated based on the average of the individual's three highest years of combined salary in both systems and the individual's contributions, interest, and years of credited service in the system performing the retirement calculation. The combined service credited in both retirement systems is used to determine vesting, early retirement and superannuation retirement eligibility in either retirement system. The amount necessary to fund the annuity payable by the first system is then transferred to the system in which the individual was last active. The two annuities are combined and the retired member receives one monthly check that is paid from the system in which the individual was an active, contributing member prior to retirement. In most cases, the election of multiple service is of benefit to the member because it normally results in a final benefit calculation that is greater than would be the case if the retirement service credit of the two systems were not combined.

Prior to the passage of Act 9 of 2001, the multiple service election period was only 30 days in length. Currently, under both the PSERS and SERS Codes, an eligible active member must elect multiple service within 365 days of becoming a member of the new retirement system. Act 9 also opened a one-time election period applicable to eligible active members of both PSERS and SERS from May 17, 2001, to December 31, 2003.

In some cases, an individual member may have withdrawn contributions and interest from the first retirement system upon terminating service, or in the case of a retired member, may have begun receiving annuity benefit payments. Upon electing multiple service membership in the second retirement system, any annuity payments being made to the individual cease and an individual who is receiving annuity payments from the first system must repay the first system for any annuity payments received or for any withdrawn contributions, plus interest.

The prospect of repaying what may amount to a significant sum of money can sometimes deter an otherwise eligible member from electing multiple service. Some individuals who are otherwise eligible simply choose not to elect multiple service membership, while others may overlook the option in the midst of other matters in the first 365 days of employment with a new employer. Later, some may come to regret their decision, arguing that they should be afforded another opportunity to elect multiple service because they did not fully appreciate the value of the option at the time. For some, an additional issue may involve difficulties in obtaining proper documentation from a previous employer for employment that took place many years in the past.

The bill seeks to rectify past problems with understanding the multiple service election option by providing eligible active members of SERS with a one-time election period, beginning with the effective date of the bill and ending December 31, 2008. Because the bill amends only the SERS Code, only SERS members with previous service credit in PSERS would be eligible for the window. PSERS members wishing to elect multiple service membership would not be eligible to elect multiple service under the proposed election window.

The Commission's consulting actuary has suggested that it may be desirable to entirely eliminate the 365-day limit for multiple service election, and thus, remove any perceived need for future temporary election periods. In order to anticipate and adequately fund for such a scenario, multiple service election by eligible members would be treated by the actuaries of both PSERS and SERS as a certainty. Both PSERS and SERS would routinely collect and periodically share demographic information on all potentially eligible members and update that information on an annual basis.

SUMMARY OF ACTUARIAL COST IMPACT

Cost-of-Living Adjustments

The Commission's consulting actuary has reviewed the bill as amended and the actuarial cost estimates provided by the actuaries of the respective retirement systems and determined that the cost-of-living adjustments provided by the bill will have the following actuarial cost impact.

Public School Employees' Retirement System

	Amount	
Increase in Unfunded Actuarial Accrued Liability	$1,932,900,000	
	Amount	**As a % of Projected Payroll**
Increase in Employer Annual Cost		
Amortization Payment [1]	$221,600,000	1.73%
Total Increase in Employer Annual Cost	$221,600,000	1.73%

[1] First year amortization payment. 20-year amortization period, paid in part by the Commonwealth and in part by the school districts and other educational employers. Amortization payments cease after 20 years.

State Employees' Retirement System

	Amount	
Increase in Unfunded Actuarial Accrued Liability	$1,024,900,000	
	Amount	**As a % of Projected Payroll**
Increase in Employer Annual Cost		
Amortization Payment [1]	$108,300,000	1.90%
Total Increase in Employer Annual Cost	$108,300,000	1.90%

[1] First year amortization payment. 20-year amortization period. Amortization payments cease after 20 years.

Multiple Service Election Window

The Commission's consulting actuary has reviewed the multiple service election component of the bill as amended and determined that because SERS is unable to identify the active members of SERS who may be eligible to elect multiple service membership under the bill, no reliable actuarial cost estimate can be made. Any actuarial cost impact resulting from implementation of the multiple service election window will be dependent upon both the number of eligible members who actually elect multiple service and the individual demographics (credited service, payroll, etc.) of those members. SERS would experience an increase in actuarial cost to the extent that the additional service credit resulting from the election of multiple service may permit an affected member to become eligible for normal retirement benefits earlier than would otherwise be the case or may enable a multiple service member to qualify for future early retirement incentives or other collateral benefits. PSERS would also experience an increase in actuarial cost because an affected member's benefit would normally be calculated using a higher final average salary and possibly a higher benefit accrual rate. Additionally, PSERS would be required to transfer to SERS the full amount required to fund the PSERS component of an affected multiple service member's benefit at the time of the member's retirement rather than paying the benefit over the course of the member's remaining retired lifetime.

POLICY CONSIDERATIONS

In reviewing the bill as amended, the Commission identified the following policy considerations.

Appropriateness of Postretirement Adjustment. Generally, increasing the pension benefits of members during the course of retirement in order to offset erosion in the purchasing power of the pension benefit due to the effects of inflation is a common practice in the public sector. The General Assembly and the Governor must determine whether the postretirement adjustments proposed in the bill are appropriate given the cumulative effect of previous COLAs combined with changes in the cost of living that have been experienced in recent years.

COLA Eligibility Criteria. The language of the bill would have the effect of excluding from eligibility for the COLA those annuitants who, while active members, received the benefit enhancements provided by Act 9 of 2001. Depending on the class of service, these members received a significant benefit enhancement applicable to all periods of service (25% or 50%). The most recent COLA provided to members of PSERS and SERS under Act 38 of 2002, specifically excluded these members (membership classes AA, T-D and D-4) from COLA eligibility. It may be reasonable to exclude this group of annuitants from eligibility for the COLAs provided by the bill in light of the significantly greater benefits being received by this subgroup of annuitants.

Impact on Future Employer Contribution Rates. Because its implementation represents a change in the benefit provisions of the Systems, the costs of providing the ad hoc COLA provided by the bill must be added to the unfunded accrued liability of the respective Systems and funded prospectively by amortization payments over a 20-year period rather than the 10-year amortization period currently required by law. The additional liability resulting from enactment of the COLA will necessitate increased employer contributions to the Systems by the Commonwealth and public school employers. The General Assembly and the Governor must determine whether the increased employer contribution requirements resulting from the bill are appropriate and acceptable at this time.

Delayed Funding Commencement. The bill would mandate COLA payments for eligible annuitants of both PSERS and SERS beginning with the first monthly annuity payments after July 1, 2008, but would delay the commencement of funding for those benefits until July 1, 2009. Ideally, funding of the COLAs should commence at the same time as commencement of the increased benefit payments. Delayed funding generally serves only to increase the cost of providing the benefit enhancement. The delayed commencement of funding may be justified in the case of PSERS in order to permit public school districts and other educational employers to have adequate time to budget for the additional contributions that will be required to fund the benefit increase. However, the need to delay funding of the Commonwealth's portion of the required contributions to PSERS and the Commonwealth's contributions to SERS is unclear.

Absence of Need Determination Factor. Change in the Consumer Price Index (CPI) during an applicable period of retirement is the predominate basis for determining the amount of COLAs provided in public employee retirement plans. The bill does not appear to take into account an appropriate need factor based upon change in the CPI and the cumulative effects of past COLAs on the annuity payments of affected retirees.

Inter-System Parity (COLAs). Historically, the General Assembly has engaged in the practice of providing substantially similar benefits to both State and public school employees. The COLA proposal in the bill conforms to this trend by providing a COLA to retired members of both Systems.

Inter-System Parity (Multiple Service Election). Historically, the General Assembly has engaged in the practice of providing substantially similar benefits to both State and public school employees. The ability to elect multiple service membership is a benefit entitlement currently afforded to eligible active members of both PSERS and SERS. Because the bill would provide a multiple service election window applicable to eligible active members of SERS only, the proposal in the bill does not conform to this trend.

Conformance with Policy Guidelines. In response to Senate Resolution 103 (1999 Session), the Public Employee Retirement Commission released a report entitled *Funding Cost-of-Living Adjustments* in November 2000. The bill conforms to some and does not conform to other of the Commission's recommendations in the report with respect to the funding of ad hoc cost-of-living adjustments.

General Funding Approach. Both the citizens and the policymakers of the Commonwealth benefit when the costs of any proposed benefit modification in a public employee retirement plan are funded in a straightforward manner. The Commonwealth has used a direct funding approach consistently since the initial ad hoc cost-of-living adjustment was implemented in 1968. An ad hoc cost-of-living adjustment is a modification in the benefit provisions of the Commonwealth's statewide retirement plans that has a definite, determinable cost. Utilization of a direct funding approach is necessary to provide a discernable relationship between the costs incurred in implementing an ad hoc cost-of-living adjustment and the increased funding requirements attributable to those costs. The bill appears to permit a direct funding approach for the liabilities incurred in the provision of the COLA.

Amortization Period. The bill does not retain the 10-year level-dollar amortization approach recommended by the Commission and currently utilized by both PSERS and SERS for the funding of future COLA liabilities. Instead, the bill would increase the level-dollar amortization period from 10 years to 20 years. The use of a shorter amortization period is generally desirable because it reduces the interval between the point in time when the liability is incurred and the point in time when the liability is funded and thereby reduces the degree of inter-generational cost transfer. The use of a shorter amortization period reduces the total amount of the amortization payments required to fund the liability, and limits the potential for compounded amortization payments attributable to multiple cost-of-living adjustments.

Partial Pre-funding of COLA Liabilities. Senate Resolution Number 103 (1999 Session) declared that the General Assembly is concerned with funding cost-of-living adjustments in the most economical manner, and efficiency in governmental operations is viewed as an appropriate objective by the citizens of the Commonwealth. In its report, the Commission recommended that the SERS and PSERS Codes be amended to provide a specified percentage of payroll contribution to be included in the annual determinations of the employer contribution rates as a means to provide advance direct funding for future COLAs and that the resulting contributions be placed in restricted accounts and used to partially pre-fund the liabilities of future cost-of-living adjustments. The systematic accumulation of monies within SERS and PSERS dedicated to reduce the unfunded liabilities incurred in the provision of future cost-of-living adjustments is a reasonable mechanism to achieve modified advance direct funding. The bill contains no provision for the partial pre-funding of future COLA liabilities.

Dissimilar Policy Objectives. The objective of a welfare postretirement adjustment is to address inadequacies in subsistence level retirement benefits caused by changes in compensation and other standard-of-living factors over an extended period of retirement. The objective of a cost-of-living postretirement adjustment is to address the incremental erosion of the purchasing power of retirement benefits caused primarily by inflation. Although the Commonwealth has not provided specific welfare postretirement adjustments, the last four cost-of-living postretirement adjustments (2002/03, 1998, 1994, 1989) that it has implemented have included provisions to provide long-term retirees significantly larger increases than short-term retirees. These provisions were initiated as a means of assisting long-term retirees receiving very low retirement benefits. Although targeting long-term retirees for higher benefits within a cost-of-living adjustment is one way to address the diminishment of the relative value of retirement benefits caused by changes in compensation and other standard-of-living factors over time, the practice may not be the most appropriate method within the context of a cost-of-living postretirement adjustment due to the dissimilar dual policy objectives involved.

COMMISSION RECOMMENDATION

On May 22, 2008, the Commission voted to attach the actuarial note to the bill as amended, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2084, Printer's Number 3689, was re-referred to the House Appropriations Committee on May 6, 2008.

Bill ID: Amendment Number 07098 to
House Bill Number 2084, Printer's Number 3689

System: Public School Employees' Retirement System

Subject: Supplemental Annuity Reserve Account

SYNOPSIS

Amendment Number 07098 to House Bill Number 2084, Printer's Number 3689, would amend the bill and, in-turn, the Public School Employees' Retirement Code (Code) to:

1) establish a new ledger account within the Public School Employees' Retirement Fund (Fund), known as the Supplemental Annuity Reserve Account, from which payments for the 2008 supplemental annuities provided under House Bill Number 2084 and all future supplemental annuities enacted subsequent to July 1, 2010, will be paid;

2) divert ("set-aside") interest earnings of the Fund in excess of the actuarial interest rate assumption (currently 8.5 percent) to the Supplemental Annuity Reserve Account beginning June 30, 2008; and

3) At the end of any year beginning July 1, 2008, or thereafter in which the Fund's "time-weighted rate of return" is less than the Board's actuarial interest rate assumption, debit the Supplemental Annuity Reserve Account and credit the State Accumulation Account for the difference in the interest rate multiplied by the mean amount in the Annuity Reserve Account for the preceding year.

DISCUSSION

The Public School Employees' Retirement System (PSERS or System) is a governmental cost-sharing multiple-employer retirement system established by the Commonwealth to provide retirement, disability, death, and health care benefits to its members. Membership in PSERS is mandatory for most public school employees. Certain other employees are given the option to participate. As of June 30, 2007, there were 264,023 active and 168,026 annuitant members of PSERS. Generally, the annual retirement benefit is the product of 2.5 percent multiplied by the member's years of accumulated service credit ("eligibility points") multiplied by the member's final average (highest three years) salary.

One commonly accepted goal of a public employee retirement system is to provide a retirement benefit that is adequate at the time of retirement. Therefore, the provision of cost-of-living postretirement adjustments to ensure the adequacy of the member's benefit throughout retirement represents a logical extension of that goal. In the absence of cost-of-living adjustments, the purchasing power of retirement benefits is diminished over time due to the effects of inflation.

It has been the historical practice of the Commonwealth to grant periodic ad hoc postretirement increases to PSERS and the State Employees' Retirement System (SERS) annuitants to reflect part of the increase in the cost of living. These ad hoc postretirement adjustments have been granted roughly every five years during the period from 1967-68 to 2003. The following table displays the history of previous ad hoc postretirement adjustments.

AD HOC COST-OF-LIVING ADJUSTMENTS

	YEAR ENACTED	
NO.	PSERS	SERS
1.	1967 & 1970	1968
2.	1975	1974 & 1975
3.	1979	1979
4.	1984	1984
5.	1988	1988
6.	1994	1994
7.	1998	1998
8.	2002 & 2003	2002 & 2003

Historically, the amounts of these cost-of-living adjustments have been roughly equivalent to one-half to two-thirds of the increase over the applicable period in the Consumer Price Index for all Urban Consumers (CPI-U), which is calculated by the Bureau of Labor Statistics of the United States Department of Labor and which is a frequently used measure of changes in the cost-of-living nationally.

Granting a cost-of-living adjustment usually involves assuming a debt. The additional costs associated with the provision of a cost-of-living adjustment are added to the unfunded actuarial accrued liability of the retirement system and funded prospectively through amortization payments. Depending upon when they were enacted, previous cost-of-living adjustments were funded on a 20-year level dollar, 20-year level percentage, or 10-year level dollar basis. Under current law, all future cost-of-living adjustments must be funded over a 10-year period using level dollar amortization contributions.

The funding for PSERS comes from three primary sources: 1) employer and Commonwealth contributions, 2) employee contributions, and 3) investment earnings. The PSERS contribution policy is set by the Code and required contributions are made by active members, school employers, and the Commonwealth. On a statewide basis, in the aggregate, employers and the Commonwealth equally share the cost of required contributions. The Code sets the rate of contribution for active members of PSERS as a percentage of the member's compensation and is dependent upon the member's class of service. The contributions required of employers and the Commonwealth are based upon an annual actuarial valuation, using the entry age normal actuarial cost method, computed as a percentage of the total compensation of all active members during the period for which the amount is determined.

The public employee pension trust fund created under the Code is the Public School Employees' Retirement Fund (Fund). Among the ledger accounts of the Fund are four accounts designated by the Code. These are the: 1) Member Savings Account (i.e., fund balance reserved for member contributions), 2) State Accumulation Account (i.e., fund balance reserved for employer contributions), 3) Annuity Reserve Account (i.e., fund balance reserved for benefits), and 4) Health Insurance Account (i.e., fund balance reserved for postretirement medical insurance). Additionally, because the Code provides for disability benefits, there also is a Reserve for Disabilities Account (i.e., fund balance reserved for disability benefits).

> The *Member Savings Account (MSA*) is credited with all employer pickup contributions, and payments made by members, plus statutory interest of four percent. A member's accumulated deductions are transferred from the MSA to the Annuity Reserve Account (ARA) upon the member's retirement or death for the payment of benefits. The MSA also pays accumulated deductions to the member if the member withdraws from the System.
>
> The *State Accumulation Account (SAA)* is credited with the contributions of the Commonwealth and the school employers. Additionally, all interest earnings of PSERS (after crediting the Member's Savings Account with four percent statutory interest and the Annuity Reserve Account and Reserve for Disabilities Account with 5.5 percent valuation interest) are credited to this account. Each year, the necessary amounts, as determined by the actuary for the payment of retirement and death benefits, are transferred from the State Accumulation Account to the Annuity Reserve Account and the Reserve for Disabilities Account. All administrative expenses necessary for the operation of PSERS, except for the Health Insurance Account expenses, are charged to the State Accumulation Account.
>
> The *Annuity Reserve Account (ARA)* represents the amounts transferred from the Member Savings Account and the State Accumulation Account, plus additional contributions made by the Commonwealth and employers for the payment of cost-of-living adjustments (termed supplemental annuities in the Code). All death and retirement benefits are charged to the account. Annual valuation interest of 5.5 percent is credited to the account.
>
> The *Health Insurance Account (HIA)* is credited with contributions of the Commonwealth and the employers. Participating eligible annuitants receive health insurance premium assistance payments which are charged to the account. All administrative expenses necessary to operate the health insurance premium assistance program also are charged to the account.

Amendment Number 07098 would establish a new ledger account to be known as the Supplemental Annuity Reserve Account that would function as follows:

> The Supplemental Annuity Reserve Account, rather than the Annuity Reserve Account, would be credited with future contributions made by the Commonwealth and employers for the payment of the 2008 supplemental annuities and all future supplemental annuities enacted subsequent to July 1, 2010.
>
> Beginning July 1, 2009, charge the Supplemental Annuity Reserve Account for the supplemental annuity payments attributable to the July 1, 2008, and all future supplemental annuities, rather than the Annuity Reserve Account.
>
> Beginning June 30, 2008, divert "set-aside" interest earnings calculated as the product of the difference of the Fund's time-weighted rate of return for the preceding year minus 8.5% multiplied by the mean amount of the Annuity Reserve Account for the preceding year to the Supplemental Annuity Reserve Account.

> Beginning July 1, 2008, at the end of any year in which the Fund's "time-weighted rate of return"(as defined in the bill) is less than the Board's actuarial interest rate assumption, debit the Supplemental Annuity Reserve Account and credit the State Accumulation Account for the difference in the interest rate multiplied by the mean amount in the Annuity Reserve Account for the preceding year.

Among PSERS' economic actuarial assumptions is one for earnings on investments, which is currently 8.5 percent. The 8.5 percent earnings assumption was adopted by the Board after undergoing its most recent five-year actuarial experience review and is based on the recommendations of the System's consulting actuary. Based upon PSERS' more than 90 years of experience, the asset mix of the Fund, the Board's other actuarial assumptions, and other information, 8.5 percent represents the Board's expectation of the mean long-term return on the investments of the PSERS Fund. If future five-year experience reviews reveal that economic conditions warrant a change in the interest rate assumption, the Board may change it.

The economic actuarial assumption for interest represents a long-term expectation that investment returns will be over the assumed rate about one-half of the time, will be under the assumed rate about one-half of the time, and will revert to a mean value of the assumed rate. In the short term, however, there will be periods of earnings over and under the long-term rate. A significant positive balance in the Supplemental Annuity Reserve Account after a cycle of rising interest earnings could lead to the contention that a substantial supplemental annuity should be granted. Conversely, a significant negative balance in the account after a cycle of falling interest earnings could lead to the contention that, no matter what increases have occurred in the cost of living, no supplemental annuities should be granted. The result could be that the public pension policy of the Commonwealth regarding the granting of supplemental annuities would be driven by the recent interest earnings of PSERS rather than on the needs of retired members and the overall long-term cost to the System.

If the Board's actuarial assumptions are correct, the long-term effect of the amendment will be neutral. The proposal in the amendment will neither increase nor decrease total employer contributions in the long-term. Over time, the crediting of certain interest earned over the actuarial interest rate assumption and the charging for certain interest earned under the actuarial interest rate assumption to the Supplemental Annuity Reserve Account will be offset in equal part by higher or lower employer contributions to fund the liabilities of PSERS.

The amendment appears to be an attempt to pre-fund or partially pre-fund future cost-of-living adjustments. While the pre-funding of cost-of-living postretirement adjustments is a laudable goal, the amendment fails to achieve this goal because it provides no new funding to PSERS. If supplemental annuities are to be pre-funded, new funding must be provided. The proposed crediting and charging of investment earnings over and under the actuarial interest rate assumption provides no new funding to PSERS.

The proposal in the amendment will ultimately do nothing to mitigate the increased pension costs associated with providing cost-of-living adjustments to retired public school employees. The timing of the payment of these costs would be modified, but the total cost of benefits will remain unchanged. As noted previously, this is the case because the bill provides no new funding and would function to merely redirect existing funding among the System's ledger accounts. Utilization of the "excess interest" concept sometimes is misconstrued as reducing the costs to be incurred, but at best the proposal in the amendment would be cost-neutral. In practice, it is more likely that the proposal would result in increased short-term costs.

It is important to understand that there never is "excess" interest in a public employee retirement system such as PSERS, because these "excess"sums are retained in the fund and are recognized over time as actuarial gains. These gains may then be passed on to employers and the Commonwealth in the form of reduced employer contribution requirements. If, however, these gains are appropriated for another purpose, such as for the payment of future cost-of-living adjustments, then the funds would not be available to offset losses in unfavorable investment years, resulting in higher employer and Commonwealth contribution requirements than would otherwise be the case under current Code provisions.

SUMMARY OF ACTUARIAL COST IMPACT

The consulting actuary for the Commission has reviewed the amendment and advises that, based on fundamental economics, the amendment will not cause a change in the aggregate amount of employer contributions over the long-term. The amendment creates a separate reserve account within the existing Fund and provides a mechanism to transfer credits and debits between accounts. As the amendment does not, per se, increase or reduce benefits, expenses, or investment returns, the aggregate contribution requirements of PSERS should not be affected. However, the Commission's consulting actuary also believes that, conceptual and technical issues aside, the amendment has the potential to cause short-term volatility in future employer and Commonwealth contribution requirements to the System beyond those that would otherwise be required under current law.

POLICY CONSIDERATIONS

In reviewing the amendment, the Commission identified the following policy considerations:

> <u>Erroneous Concept</u>. The amendment appears to be premised on the belief that the Fund's investment experience will consistently outperform investment expectations for an extended period. This belief is not supported by either the Fund's long-term investment experience or the current economic actuarial assumptions as adopted by the PSERS Board in consultation with the System's actuary.
>
> <u>Policy Distortion Potential</u>. The proposal in the amendment would tend to make the granting of supplemental annuities a function of the balance in the Supplemental Annuity Reserve Account rather than a function of the needs of the System's retirees as reflected in the change in the cost of living.
>
> <u>Potential Short-Term Volatility in Employer Contribution Rates</u>. The amendment has the potential to create unnecessary volatility in future employer contribution requirements under certain conditions. There is never "excess" interest in a public employee retirement system such as PSERS, because these "excess"sums are returned to the Fund and are recognized over time as actuarial gains. The resulting gains can be used to offset unfavorable plan experience in future years and may be passed on to school employers and the Commonwealth in the form of reduced employer contribution requirements. If, however, these gains are appropriated for another purpose, such as for the payment of future supplemental annuities, then these assets will no longer be available to offset losses in unfavorable investment years. The result would be greater employer and Commonwealth contribution requirements than would otherwise be the case under current law.

Complexity of Cost/Benefit Relationship. The proposal in the amendment establishes a complicated method of funding the costs incurred in the provision of supplemental annuities to retired public school employees. As the ultimate costs to the Commonwealth and the employers are neither increased nor decreased by the amendment, there appears to be no public pension policy rationale for replacing the more straight forward funding approach prescribed under current law.

Funding for Supplemental Annuities. The amendment will do nothing to alter the ultimate cost of supplemental annuities provided to retired public school employees because there is no new funding provided through the operation of the proposed Supplemental Annuity Reserve Account. The timing of the payment of the costs will be modified, but the total costs of the benefits will be the same. If it is the intent of the General Assembly to fully or partially pre-fund for future supplemental annuities, additional funding beyond current employer contribution levels will be required for that specific purpose.

Initial Negative Balance. The amendment requires that the Supplemental Annuity Reserve Account be charged for the benefit payments resulting from the 2008 supplemental annuities provided under House Bill Number 2084 and all future supplemental annuities enacted subsequent to July 1, 2010. This requirement would have the effect of creating an initial negative balance in the newly created Supplemental Annuity Reserve Account equal to the fiscal year 2008-09 benefit payments resulting from the cost-of-living adjustment under the bill. The amendment does not address how negative balances in the proposed Supplemental Annuity Reserve Account are to be handled or funded.

Disbursal Mechanism. The amendment provides for the accumulation of funds in the Supplemental Annuity Reserve Account, but provides no mechanism for actually paying supplemental annuities. In the absence of a disbursal mechanism, an act of the General Assembly would be required to direct the System to pay a future supplemental annuity from assets accruing to the Supplemental Annuity Reserve Account.

COMMISSION RECOMMENDATION

On June 25, 2008, the Commission voted to attach the actuarial note to the amendment, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2084, Printer's Number 3689, was re-referred to the House Appropriations Committee on May 6, 2008.

Bill ID: Amendment Number 07099 to
House Bill Number 2084, Printer's Number 3689

System: Public School Employees' Retirement System and
State Employees' Retirement System

Subject: Excluding from Eligibility for Ad Hoc Cost-of-Living Adjustments those
Annuitants with Credited Service in Membership Class D-3 or D-4

SYNOPSIS

House Bill Number 2084, Printer's Number 3689, would: 1) amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code to provide an ad hoc cost-of-living adjustment (COLA) (referred to as "supplemental annuities" in the governing statutes of the retirement systems) to annuitants of both the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS), commencing with the first monthly annuity payment after July 1, 2008; and 2) amend the State Employees' Retirement Code by opening a temporary "window" (beginning on the effective date of the bill and ending December 31, 2008) for members of SERS who have credited service in PSERS, were once eligible to elect multiple service membership, but who failed to elect multiple service membership within the current 365-day limit imposed by the SERS Code.

To be eligible for the COLA, superannuation and disability annuitants must be receiving an annuity on July 1, 2008, and have an effective date of retirement prior to July 2, 2007. Withdrawal annuitants will not be eligible to receive the COLA until the first day of July coincident with or following attainment of superannuation (normal retirement) age. The bill would also mandate a change in the amortization of the additional liabilities attributable to the COLA provided by the bill and all future COLAs from the currently mandated 10-year level-dollar amortization period to a 20-year level-dollar amortization period with funding commencing July 1, 2009.

Amendment Number 07099 would amend the bill to exclude from eligibility for the COLAs those annuitants who have credited service in membership classes D-3 or D-4.

DISCUSSION

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer, defined benefit retirement systems. The designated purposes of the Public School Employees' Retirement System and the State Employees' Retirement System (Systems) are to provide retirement allowances and other benefits, including disability and death benefits to public school and State employees.

Membership in the Systems is mandatory for most school and State employees. Certain other employees are not required but are given the option to participate. As of June 30, 2007, PSERS had 264,023 active members and 168,026 annuitants and beneficiaries. As of December 31, 2007, SERS had 109,610 active members and 107,130 annuitants and beneficiaries.

Generally, the annual retirement benefit for most members of SERS (Class AA) and PSERS (Class T-D) is the product of 2.5 percent multiplied by the member's years of accumulated service credit, multiplied by the member's final average (highest three years) salary.

Under the Public School Employees' Retirement Code, superannuation or normal retirement age is age 62 with at least one full year of service, age 60 with 30 or more years of service, or any age with 35 years of service. Under the State Employees' Retirement Code, superannuation or normal retirement age for most members is age 60 with three years of service or any age with 35 years of service, while age 50 is the normal retirement age for members of the General Assembly and certain public safety employees.

One commonly accepted goal of a public employee retirement system is to provide a retirement benefit that is adequate at the time of retirement. Therefore, the provision of cost-of-living postretirement adjustments to ensure the adequacy of the member's benefit throughout retirement represents a logical extension of that goal. In the absence of cost-of-living adjustments, the purchasing power of retirement benefits is diminished over time due to the effects of inflation.

It has been the defacto policy of the Commonwealth to grant periodic ad hoc postretirement increases to PSERS and SERS annuitants to reflect part of the increase in the cost of living. These ad hoc postretirement adjustments have been granted roughly every five years during the period from 1967-68 to 2003. Historically, the amounts of these cost-of-living adjustments have been roughly equivalent to one-half to two-thirds of the increase over the applicable period in the Consumer Price Index for all Urban Consumers (CPI-U), which is calculated by the Bureau of Labor Statistics of the United States Department of Labor and which is a frequently used measure of changes in the cost-of-living nationally.

Granting a cost-of-living adjustment involves undertaking the functional equivalent of a long-term debt. The additional costs associated with the provision of a cost-of-living adjustment are added to the unfunded actuarial accrued liability of the retirement system and funded prospectively through amortization payments. Depending upon when they were enacted, previous cost-of-living adjustments were funded on a 20-year level dollar, 20-year level percentage, or 10-year level dollar basis. Under current law, all future cost-of-living adjustments must be funded over a 10-year period using level dollar amortization contributions.

Under the bill, the amount of the COLA is based upon the annuitant's most recent effective date of retirement. The total percentage increase payable to eligible annuitants of both Systems under the COLA is shown in the following table.

Most Recent Effective Date of Retirement	Percentage Increase
July 2, 2006 through July 1, 2007	2.67%
July 2, 2005 through July 1, 2006	4.01%
July 2, 2004 through July 1, 2005	5.85%
July 2, 2003 through July 1, 2004	7.67%
July 2, 2002 through July 1, 2003	8.75%
July 1, 2001 through July 1, 2002	9.15%
July 2, 1997 through June 30, 2001	10.00%
July 2, 1990 through July 1, 1997	15.00%
Prior to July 2, 1990	25.00%

Amendment Number 07099 would amend the bill to exclude from eligibility for the COLAs those annuitants who have credited service in membership classes D-3 or D-4.

Prior to July 1, 2001, most State employees were Class A members, and most school employees were members of Class T-C. Both Class A and Class T-C have an annual benefit accrual rate equal to 2.0 percent of final average salary. Act 9 of 2001 created several new classes of service; Class AA for most members of SERS and Class T-D for members of PSERS. The annual benefit accrual rate applicable to both Class AA and T-D service is 2.5 percent of final average salary.

Additionally, under the SERS Code, there are a number of special membership classes, members of which are entitled to enhanced benefit accrual rates, reduced normal retirement eligibility criteria, or both.

Among these special membership classes, are two classes of service applicable to certain members of the Pennsylvania General Assembly. Members of the General Assembly who were in office prior to March 1, 1974, had the option of electing membership in SERS membership Class D-3. An active member of this class of service continues to be credited for service as Class D-3 until the member moves into a different membership classification or terminates employment. The normal retirement age for this class is age 50 or the age the member accumulates 35 years of service credit, whichever first occurs. Class D-3 members also earn service credit at an enhanced rate, accumulating one and two thirds (1.6667) eligibility points for each year of service credit. The employee contribution rate for Class D-3 is 18.75 percent of pay, computed by multiplying the Class D-3 class of service multiplier (3.75) by the basic contribution rate (5.0 percent). The annual benefit accrual rate for this class is 7.5 percent, computed by multiplying the Class D-3 class of service multiplier (3.75) by the basic benefit accrual rate (2.0 percent).

Act 9 of 2001 created a new class of service applicable to most current and all future members of the General Assembly known as Class D-4. Under Act 9, members of the General Assembly who were Class A members were eligible to elect Class D-4 until June 30, 2001. Those members who did not make a timely D-4 election were entitled to elect Class AA service credit until December 31, 2001, but affected members may not switch between Class AA and D-4. Any member of the General Assembly who becomes a member of SERS after June 30, 2001, automatically becomes a Class D-4 member. The class of service multiplier for Class D-4 is 1.5, which translates into an annual benefit accrual rate of 3.0 percent with regular member contributions of 7.5 percent. As with Class D-3 members, the superannuation (normal retirement) age for Class D-4 members is age 50.

Because of the higher benefit accrual rates and reduced superannuation requirements applicable to both Class D-3 and D-4 membership, and because Class D-3 members contribute at a higher than normal rate, both Class D-3 and D-4 members generally are entitled to significantly enhanced retirement benefits in comparison to most other Commonwealth and public school employees.

It would appear that the intent of the amendment is to remove annuitants with Class D-3 and D-4 service from eligibility for the COLAs provided by the bill based upon the premise that a COLA is not warranted in the case of these annuitants due to the enhanced benefits to which such members would normally be entitled. However, not all current and former members of the General Assembly are Class D-3 or D-4 members. Some current and many former members are Class A members, while others may have elected to become Class AA members when that option was available. Some may have elected to forego membership in SERS altogether, as SERS membership is not mandatory for members of the General Assembly. However, any member of the General Assembly who became a member of SERS after June 30, 2001, is automatically enrolled as a Class D-4 member.

Amendment Number 07099 would remove from eligibility for the COLAs provided by the bill those annuitants with any credited service in membership classes D-3 or D-4. The Commission's consulting actuary has reviewed the amendment and the actuarial cost estimates provided by the actuaries of the respective retirement systems.

SERS and PSERS have identified a total of 154 annuitants currently receiving retirement benefit payments who have service that was credited in Class D-3 or D-4. Of these, 15 are multiple service members and annuitants of PSERS. Because annuitants with credited service in membership classes D-3 and D-4 represent such a small component of the total annuity payroll of both PSERS and SERS, removing these members from eligibility for the COLAs provided by the bill would result in a de minimis reduction in the actuarial cost impact of the bill.

The actuarial cost impact of the COLAs provided by the bill are summarized in the following tables.

Public School Employees' Retirement System

	Amount
Increase in Unfunded Actuarial Accrued Liability	$3,036,000,000

	Amount	As a % of Projected Payroll
Increase in Employer Annual Cost		
Amortization Payment [1]	$348,100,000	2.71%
Total Increase in Employer Annual Cost	$348,100,000	2.71%

[1] First year amortization payment. 20-year amortization period, paid in part by the Commonwealth and in part by the school districts and other educational employers. Amortization payments cease after 20 years.

State Employees' Retirement System

	Amount
Increase in Unfunded Actuarial Accrued Liability	$1,564,900,000

	Amount	As a % of Projected Payroll
Increase in Employer Annual Cost		
Amortization Payment [1]	$165,400,000	2.90%
Total Increase in Employer Annual Cost	$165,400,000	2.90%

[1] First year amortization payment. 20-year amortization period. Amortization payments cease after 20 years.

POLICY CONSIDERATIONS

In reviewing the amendment, the Commission identified the following policy considerations:

<u>COLA Eligibility Criteria</u>. The amendment would have the effect of excluding from eligibility for the COLAs provided by the bill those annuitants who are former members of the General Assembly with accumulated service credit in Class D-3 or D-4. Depending on the class of service, these members are generally entitled to significantly enhanced retirement benefits in comparison with most other former Commonwealth and public school employees. For this reason, it may seem reasonable to exclude this group of annuitants from eligibility for the COLAs in light of the enhanced benefits being received by this subgroup of annuitants. However, because annuitants with credited service in membership classes D-3 and D-4 represent such a small component of the total annuity payroll of both SERS and PSERS, removing these members from eligibility for the COLAs provided by the bill would have virtually no effect on the bill's actuarial cost impact. Therefore, if the objective of the amendment is to achieve a significant cost reduction by removing this subgroup of annuitants from COLA eligibility, the amendment does not achieve that objective.

<u>Exclusion by Special Membership Class</u>. The amendment would exclude from COLA eligibility under the bill those annuitants with "*... any service credited as either Class D-3 or Class D-4 service.*" As such, the amendment makes no distinction between an annuitant who, for example, spent a 30-year career as a D-3 member of the General Assembly and an annuitant who may have only a few years of service credit in either Class D-3 or D-4 and who spent the majority of his or her career in some other type of Commonwealth or school employment. In the latter example, an annuitant for whom Class D-3 or D-4 service was only a small component of their total service, such a member would not necessarily be entitled to a significantly enhanced retirement benefit. Therefore, excluding a member from COLA eligibility based solely upon that member's service credit in a particular membership class, however brief, would seem to be unwarranted.

<u>Not All Former Members of the General Assembly Excluded</u>. Not all current and former members of the General Assembly are Class D-3 or D-4 members of SERS. Some current and many former members have all or most service credited as Class A, while others may have elected to become Class AA members when that option was available. If it is the intent of the amendment's sponsor to exclude all former members of the General Assembly who are PSERS or SERS annuitants from eligibility for the COLAs provided by the bill, then the amendment does not achieve that objective.

<u>Other Special Membership Classes</u>. In addition to membership classes D-3 and D-4, there are several other special membership classes under the SERS Code that are entitled to enhanced benefits, reduced superannuation requirements, or both. These include all members of the judiciary, certain enforcement officers and Pennsylvania State Police Officers. Additionally, certain highly compensated employees would be entitled to enhanced retirement benefits by virtue of their higher than normal final average salary calculations. Under the bill, these annuitants would remain eligible for the COLAs. If it is the objective of the amendment to remove from eligibility for the COLAs in the bill certain annuitants who receive enhanced retirement benefits, then these additional subgroups should also be removed from COLA eligibility.

COMMISSION RECOMMENDATIONS

On June 25, 2008, the Commission voted to attach the actuarial note to the amendment, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

House Bill Number 2084, Printer's Number 3689, was re-referred to the House Appropriations Committee on May 6, 2008.

Bill ID: House Bill Number 2472, Printer's Number 3634

System: All Municipal Pension Systems

Subject: Deferred Retirement Option Plans (DROPs)

SYNOPSIS

The bill would amend the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) to provide statutory guidance for the establishment, administration and regulation of Deferred Retirement Option Plans (DROPs) by local governments in the Commonwealth of Pennsylvania. More specifically, the bill would:

Authorize a local government with a defined benefit pension plan to establish a DROP as part of the plan;

Permit a member of such a pension plan who is or will be eligible for normal retirement to elect to participate in the DROP;

Prohibit participation by elected officials;

Provide for DROP election forms;

Provide for early termination of DROP participation by a member without a penalty;

Require that DROP participation begin the day after normal retirement and continue for the period specified in the DROP ordinance;

Require that the normal retirement benefits of a DROP participant, together with interest, be credited to a separate subsidiary account;

Require that the interest credited to a DROP participant's account be not less than 1% nor more than 4.5% annually;

Require that the DROP participant's account and its separate subsidiary accounts be held in trust;

Require payment of the balance in the account to either the member or a beneficiary within 45 days after termination of DROP participation as either a lump sum or a tax-sheltered rollover distribution;

Provide protection of DROP benefits to DROP participants including protection from State and municipal taxation but permitting claims under the Public Employee Pension Forfeiture Act and qualified domestic relations orders;

Require that a DROP participant be eligible for all postretirement benefits and for most preretirement benefits normally restricted to active employees;

Provide for the crediting and payment of benefits if a DROP participant dies during the period of DROP participation;

Provide for the establishment of DROPs by the Pennsylvania Municipal Retirement System for its participating local governments;

Provide for a transition period for existing plans to conform with the DROP provisions;

Provide for rectifying future noncompliance with the DROP provisions; and

Prohibit DROP participants and their compensation from being reported as active members and active member payroll for purposes of actuarial valuation reporting under Act 205.

DISCUSSION

Under Act 66 of 1981, the General Assembly created the Public Employee Retirement Commission (Commission) and directed the Commission to give priority to formulating and recommending passage of legislation, within one year of the initial meeting of the Commission, to mandate actuarial funding standards and establish a recovery program for municipal pension systems determined to be financially distressed. The resulting statute was the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984).

Act 205 of 1984 affects every borough, city, incorporated town, township, municipal authority, and council of governments in the Commonwealth of Pennsylvania. The Act requires actuarial reporting by municipal retirement systems, establishes a minimum funding standard for every municipal pension plan, provides for the allocation of General Municipal Pension System State Aid, and establishes a recovery program for financially distressed municipal retirement systems.

Deferred Retirement Option Plans

Deferred Retirement Option Plans provide an optional way to pay retirement benefits. They permit an employee who is eligible for normal retirement to continue employment and continue to receive wages or salary as usual. But, instead of deferring retirement payments, the employee's regular monthly retirement payments commence and are deposited into an interest-bearing account. At the conclusion of employment, which coincides with the end of the DROP participation period, the employee leaves service, receives the balance in the interest-bearing account and begins to receive regular monthly retirement benefit payments. The ability to continue employment at full salary after retirement benefits commence allows the employee to accumulate resources for use in retirement that would otherwise not be available.

A DROP can benefit employers by allowing the employer to retain more senior/skilled employees who might otherwise retire and leave service. Also, the transition and replacement process for retiring employees is more predictable, and the employer is able to provide employees with a desirable retirement benefit option with potentially little or no cost. From an employee perspective, the ability to accumulate additional resources to be used in retirement is the primary attraction. Also, during the DROP period, employees may experience increased take-home pay because pension contributions typically are not required. DROPs are particularly advantageous to employees who are members of pension plans that do not provide for additional benefit accrual after attainment of retirement eligibility.

Most DROPs will increase employer administrative costs and all delay the reduction of payroll costs associated with replacing retired employees at lower salaries. Poorly designed DROPs, or those created in the absence of statutory guidance, have the potential to be unexpectedly expensive and conflict with municipal codes, Act 205 and the Municipal Police Pension Law. In the absence of carefully crafted legislation, compliance with federal anti-discrimination rules and the Internal Revenue Code could be problematic as well. Under a DROP, the employee forgoes somewhat higher ultimate monthly pension benefits, but gains the right to accumulate lump-sum pension benefits while still employed.

Because DROPs established by public sector employers are often undefined by statute, the individual design features of DROPs are extremely diverse in nature. Usually, a member must be eligible for full retirement in order to participate. Maximum DROP participation periods between two and five years are common. Typically, neither benefit accruals nor contributions take place during the DROP participation period. Most DROPs allow for the lump-sum payout of the balance in the accumulation account and many allow the participant to choose between various payout methods.

Adding a DROP to a local government defined benefit plan could either increase or decrease the long-term cost of the defined benefit plan. Key factors will be:

1) the extent to which members would elect a DROP in the future relative to the extent to which members currently defer their retirement past first eligibility for normal retirement;

2) the rate of interest credited on DROP accounts;

3) anticipated (or already negotiated) salary increases; and

4) the level of continued benefit accruals under the plan after normal retirement for members who do not participate in the DROP.

The Current Situation

The Commission has determined that there is currently no guiding or enabling statutory authority in the Commonwealth upon which local governments can draw to assist in the design and implementation of DROPs. In the absence of such guidance, DROPs have proliferated among local government pension plans in an ad hoc manner. The continued uncontrolled proliferation of DROPs serves to further complicate an already complex statutory and administrative environment. The bill would provide a uniform statutory structure to regulate the establishment and administration of DROPs by local governments. Regulating DROPs will be of benefit to local governments, local government pension plans, and ultimately the taxpayers of the Commonwealth.

During 2005, the Commission staff attempted to ascertain the status of DROPs operating at the municipal level in the Commonwealth by informally surveying all actuarial firms that certified municipal pension plan costs to the Commission under Act 205 for the 2003 filing period. All complied except one actuarial firm representing 374 of the 2,114 plans reported (approximately 18% of the statewide total). The following summarizes the results of the staff's informal survey.

<u>Number of DROPs</u>: The Commission staff identified a total of 28 DROPs operating in 25 municipalities in the Commonwealth.

<u>Length of DROP Period</u>: Of the 28 DROPs identified by the staff, 23 plans limited the participation period to no more than five years, but five DROPs did not specify a maximum period in the plan document. Six plans provided for a minimum participation period of one year.

<u>Guaranteed Interest Rate</u>: The amount of interest credited to a DROP participant's account varied considerably, with guaranteed earnings ranging from lows of less than 1% to a high of 6% annually. Those plans without guaranteed rates would provide credit for actual earnings of the pension plan.

Death Benefits: In the event of the death of a DROP participant, nineteen plans provide for payment of a regular survivor benefit based upon the date of retirement plus distribution of the DROP account balance. Nine plans provide the normal retirement benefit only, without DROP eligibility. Two of these nine plans deny the payment of any killed-in-service benefit for DROP participants, with one specifically denying the death benefit otherwise mandated by Act 30 of 2002.

Disability Benefits: Eight plans deny any eligibility for disability retirement benefits. Six plans terminate all participation in the DROP program. Five provide for service-connected disability benefits without DROP eligibility, or if the disability is not work-related, separation from service under normal retirement and payment of the DROP account balance. Three plans freeze DROP participation during any period of temporary disability, when the participant would presumably receive Workers' Compensation and/or Heart and Lung Act benefits. Two plans continue DROP participation until attainment of the specified resignation date, and four plans simply do not address the issue.

Back-DROP: Two plans have established so-called "back-DROPs" whereby DROP participation is elected at normal retirement age but is applied retroactively from the date of actual retirement. In both plans, the election to participate in the DROP can be rescinded by the participant. During the period of anticipated DROP participation, the member continues to be treated as an active member of the pension plan for all purposes, including for the purpose of allocating General Municipal Pension System State Aid.

The Commission staff is currently engaged in collecting 2007 Act 205 actuarial reporting data in connection with its regulatory responsibilities under the Act. Due to the proliferation of DROP plans, the Commission staff has begun a systematic effort to collect information on DROPs as part of the Act 205 reporting process. Based upon this reporting data, as of April 2008, the Commission staff had identified a total of 38 DROP plans operating throughout the Commonwealth.

Because of the current actual and potential future diversity of DROP provisions, it is unlikely that, in the absence of controlling legislation, DROPs created in Pennsylvania would conform to existing Commonwealth statutes. Non-conformance with Pennsylvania's Municipal Pension Plan Funding Standard and Recovery Act (Act 205) would have the potential to cause inequitable allocations in the annual distribution of General Municipal Pension System State Aid through the manipulation of employee eligibility criteria. Pennsylvania currently has no enabling legislation or guidelines for the implementation of DROPs administered by local governments. The bill would amend Act 205, adding a chapter specifically addressing this issue by implementing a uniform Pennsylvania local government DROP structure.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill and determined that, due to the absence of current comprehensive demographic and design information on DROPs currently operated by Pennsylvania local governments, no estimate of the actuarial impact of the bill can be made. However, the Commission's actuary has also noted that DROPs have, to date, been adopted by local governments in an unregulated environment. As a result, some DROPs contain provisions that may be regarded as undesirable or excessive. Because the bill does not in any way encourage or require local governments to implement a DROP, the bill would not by itself increase the costs of any local government pension plan. Instead, the bill would set forth specific statutory limitations on the key design components of both current and future DROPs. As a result, the Commission's consulting actuary has indicated that the bill would most likely reduce the costs of current and future DROPs.

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations.

Substantial Conformance with Policy Guidelines. In March 2002, the Commission released a special report entitled *Deferred Retirement Option Plans (DROPs): Authorization and Guidelines for Implementation of DROPs by Local Governments in Pennsylvania*, a report recommending policy guidelines for authorizing, designing and implementing DROPs in Pennsylvania local governments. The bill would implement the policy recommendations contained in the Commission's special report.

Statutory Authority and Guidance. The bill would provide necessary statutory authority and guidance by providing statewide legislation specifically authorizing the implementation of DROPs by Pennsylvania local governments.

Uniform Design. The bill would provide a single, uniform, statewide DROP program that fully integrates DROPs into existing pension statutes.

COMMISSION RECOMMENDATION

On May 22, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the Commission's actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2472, Printer's Number 3634, was introduced and referred to the House Local Government Committee on April 15, 2008.

Bill ID: House Bill Number 2661, Printer's Number 4012

System: Second Class (Allegheny) County Employees' Retirement System

Subject: Retirement Benefit Calculation

SYNOPSIS

House Bill Number 2661, Printer's Number 4012, would amend the Second Class County Code (P. L. 723, No. 230) in the following manner: 1) amend Section 1701 by altering the definition of "compensation" to eliminate consideration of overtime compensation from the retirement benefit calculation of a member of the retirement system who becomes a member on or after the effective date of the bill; 2) set forth a benefit formula applicable to new members at an amount equal to 50 percent of the amount that would constitute the average monthly compensation received by the member during the highest 48 months of the last eight years of employment or four years of employment on a bi-weekly pay basis during which period of time the member made monthly or biweekly contributions into the retirement fund prior to the member's retirement; and 3) amend Section 1703 by altering the membership composition of the Allegheny County Retirement Board.

DISCUSSION

Article 17 of the Second Class County Code (Code) provides the pension plan for employees of Allegheny County. The Allegheny County Retirement System (System) is a governmental, defined benefit pension plan. Membership in the System is mandatory for county employees. As of January 1, 2008, there were 7,325 active members of the System with an annual payroll of approximately $286 million. Under the Code, the normal retirement benefit is equivalent to 50 percent of the member's final average salary. The final average salary is calculated as the monthly average of the highest 24 months of compensation earned during the last 48 months of service prior to retirement.

Special retirement benefit coverage is provided to the various types of public safety employees who are employed by Allegheny County. The special coverage provided to the county sheriff, deputy sheriffs, prison guards and probation officers employed by the county is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 55 and has accumulated at least 20 years of service. The special coverage provided to firefighters and police officers is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 50 and has at least 20 years of service. The regular coverage provided to all other employees of the county is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 60 and has at least 20 years of service.

A member's compensation level is an important component in the formula used to calculate a member's retirement benefit entitlement. Generally, the higher a member's final average compensation, the greater the retirement benefit amount. Section 1701 of the Code defines "compensation" as: *Pick-up contributions plus salary or wages received per day, weekly, bi-weekly, semi-monthly, monthly, annually, or during an official term year.* To date, this definition of compensation has been interpreted to include compensation for overtime if the overtime compensation was considered "pensionable," that is, employee contributions were made to the plan on account of the additional overtime pay.

DISCUSSION (CONT'D)

Under the actuarial cost method used by the System, the System's consulting actuary employs a variety of demographic and economic assumptions that are used to determine the funding requirements of the retirement plan. Among these are assumptions for salary and salary growth applicable to the various groups of county employees. If actual plan experience differs significantly from the actuarial assumptions, for example, if the compensation used to calculate members' benefits is significantly greater than what the actuary assumed it would be, then the retirement system will suffer an actuarial loss. The bill would amend the definition of compensation applicable to all county employees hired or rehired on or after the effective date of the bill, to preclude overtime from the calculation of a member's retirement benefit.

The System employs the member's "final average salary" as one of the components of the statutory formula that is used to compute a member's retirement benefit entitlement. Currently, a member's final average salary is calculated as the monthly average of the highest 24 months of compensation earned during the last 48 months of service prior to retirement. The bill would amend Section 1712 of the Code to change the final average salary calculation applicable to employees hired on or after the effective date of the bill to the monthly average of the highest 48 months of the last eight years of employment, or the last four years of employment if compensated on a bi-weekly basis.

Only newly hired or rehired employees of Allegheny County would be subject to the benefit modifications mandated by the bill. All current employees of the county who are members of the System will continue to have the current final average salary calculation applied to the retirement benefit formula. If enacted, the bill's elimination of overtime compensation from the retirement benefit formula combined with the implementation of a less generous final average salary calculation would have the effect of functioning as a reduced benefit tier applicable to all new employees of the county.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill and determined the actuarial cost impact of the bill on the basis of the entry age normal cost method. The Commission's consulting actuary has determined that because the benefit modifications mandated by the bill would apply only to employees hired or re-employed on or after the effective date of the bill, there would be no change to the System's current actuarial accrued liability. However, future normal cost will gradually decline as new employees subject to the reduced benefit provisions of the bill are hired and current employees gradually leave service. The following table shows the estimated decrease in future annual normal cost in time increments of 5, 10, 15 and 20 years after the effective date of the bill.

Years After Effective Date of House Bill No. 2661	Decrease in Normal Cost	Decrease in Normal Cost as Percentage of January 1, 2008, Active Payroll
5	$ 634,000	0.22%
10	$1,506,000	0.53%
15	$2,685,000	0.94%
20	$4,254,000	1.49%

POLICY CONSIDERATIONS

In reviewing the bill, the Commission identified the following policy considerations:

> Reduction in Normal Cost. The bill would amend the definition of compensation applicable to all county employees hired or rehired on or after the effective date of the bill, to preclude the inclusion of overtime in the calculation of a member's retirement benefit. The bill would also mandate a less generous final average salary calculation applicable to newly hired or rehired county employees. Although these changes would do nothing to reduce the liabilities attributable to the benefit accruals of current active members, together they would have the effect of reducing the normal cost associated with the retirement benefit accruals of future employees.
>
> Reduced Benefit Tier. If enacted, the bill's elimination of overtime compensation from the retirement benefit formula combined with the implementation of a less generous final average salary calculation would have the effect of functioning as a reduced benefit tier applicable to new employees of the county.
>
> Benefit Disparity. By implementing a reduced benefit tier, the bill creates the potential for benefit inequities in the treatment of similarly situated public employees that may result in employee bargaining disputes and subsequent litigation over benefit disparities.
>
> Retirement Board Composition. The bill would amend Section 1703 of the Code to alter the composition of the Allegheny County Retirement Board by replacing certain elected officials with appointed county officials. The General Assembly must determine whether it is appropriate to replace the elected officials with appointed officials.

COMMISSION RECOMMENDATION

On September 25, 2008, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2661, Printer's Number 4012, was introduced and referred to the House Finance Committee on June 20, 2008.

PART II

PUBLIC EMPLOYEE RETIREMENT SYSTEM ADMINISTRATION

A. ACT 205 OF 1984.

- **2007 Filing Period**

March 31, 2008, was the deadline for the 2007 municipal pension plan reports. Of the 4,581 local governments submitting questionnaire responses, 2,032 indicated that they had established one or more pension plans. About 153 of the local governments required to submit employee pension plan reports to be eligible for General Municipal Pension System State Aid failed to meet the statutory filing deadline. Through transmitting multiple delinquency notices, the Commission was able to significantly reduce the number of delinquent local governments that were not included in the initial State aid certification to the Department of the Auditor General on August 1, 2008. Only 9 municipalities remained delinquent as of the date of initial certification. As of December 31, 2008, no municipalities remained delinquent in submitting their 2007 municipal pension plan reports.

With 50% of the more than 3,000 municipal pension plan actuarial valuation reports received near the filing deadline, the Commission utilized its computer-assisted review procedures to expedite the review of the incoming reports. The data extracted from the reporting forms was verified using electronic data processing. The Commission issued its *Status Report on Local Government Pension Plans* based on the 2007 Act 205 data in December 2008.

- **Municipal Pension Cost Certification**

In the summer of 2008, the Commission certified municipal pension cost data to the Department of the Auditor General for use in the 2008 allocation of General Municipal Pension System State Aid. In 2008, the State aid provided to municipalities to offset their employee pension costs totaled $206.6 million. Calculation of the municipal pension cost data for the over 1,400 municipalities was accomplished through the municipal employee pension plan data base that is maintained by the Commission through the data extracted from the over 3,000 pension plan reports submitted by municipalities.

B. ACT 293 OF 1972.

- **2008 Filing Period**

The Commission transmitted filing notices and reporting forms to the 66 counties required to submit employee pension plan reports for 2008. The reports are due by March 31, 2009.

PART III

PUBLIC EMPLOYEE RETIREMENT SYSTEM POLICY DEVELOPMENT AND COORDINATION

A. STATUTORY PROVISIONS.

The Public Employee Retirement Commission Act provides, in pertinent part:

Section 6. Powers and Duties.

(a) In general. - The Commission shall have the following powers and duties:

(1) To study generally the subject of retirement, income after retirement, disability and death benefits and the retirement needs of public employees. The Commission shall have responsibility to formulate principles and objectives applicable thereto and to recommend any new legislation it deems advisable.

(2) To analyze on its own or upon request from either the legislative or executive branch any bill relating to public employee retirement or pension policy and issue a report thereto in a timely fashion. Such report shall be submitted to the General Assembly and the Governor and shall include an assessment of the actuarial soundness, feasibility and cost of such legislation.

(9) To monitor and evaluate from time to time all the laws and systems thereunder which relate to public employee pension and retirement policy in the Commonwealth.

(10) To study the relationship of retirement and pension policy to other aspects of public personnel policy and to the effective operation of government generally.

(11) To examine the interrelationships among public employee pension and retirement systems throughout the State.

B. RESEARCH.

- ***Public Employee Retirement Laws for Pennsylvania Local Governments***

With more than 3,000 local government pension plans, Pennsylvania has the most diverse and administratively decentralized local government retirement system structure of any state in the United States. Recognizing that navigating the many state statutes affecting these pension

B. RESEARCH. (Cont'd)

systems can be a daunting task, the Commission has endeavored to provide information and assistance on this topic through an informational booklet entitled *Public Employee Retirement Laws for Pennsylvania Local Governments*. The booklet was first issued in the late 1990s and has been periodically revised and reissued as required by changes in local government pension statutes. The booklet was last issued in June 2004, and research for an updated version was completed in November 2008. The revised booklet describes the principle statutes regulating the public employee retirement systems in most of Pennsylvania's local governments, and is intended to serve as a guide to local government officials and other interested parties seeking information on Pennsylvania's many diverse local government pension systems. The booklet also contains contact information for sources of additional information and technical assistance. The booklet is available through the Commission's website, www.perc.state.pa.us.

C. STATEWIDE PUBLIC EMPLOYEE RETIREMENT SYSTEM REVIEWS

Under the Public Employee Retirement Commission Act, the Commission conducts periodic reviews of the actuarial and financial reports of the various public employee retirement systems. The Commission conducted its review of the Public School Employees' Retirement System in May 2008 and the State Employee's Retirement System in December 2008.

Commission's Review of the
Public School Employees' Retirement System Actuarial Valuation Report

At the May 22, 2008, meeting of the Commission, the Staff presented a summary of the June 30, 2007, Actuarial Valuation Report of the Public School Employees' Retirement System (PSERS) issued January 18, 2008, and reviewed some significant facts concerning the condition of the Public School Employees' Retirement System since the prior valuation.

General Funding Information

- Decrease in employer contributions for pensions of .83% (health insurance contribution rate increased .02%).
- Increase in the funded ratio from 81.2% to 85.8%.
- Unfunded accrued liability of $9,438,032,000.
- A decrease in unfunded accrued liability of $2,724,603,000.
- The unfunded accrued liability was $3,870,741,000 less than expected.
- An increase in the total normal cost to 13.97% from 13.93%.
- Employer contributions are at the 4.00% minimum employer contribution rate, plus the health insurance contribution rate (total 4.76%).

Changes in Contribution Rate

		Employer Contributions			
Fiscal Year	Member Contributions	Normal Cost	Unfunded Accrued Liability	Health Insurance	Total
2008/2009	7.29%	6.68%	(3.37)%	.76%	4.76% *
2007/2008	7.25%	6.68%	(0.24)%	.69%	7.13%
2006/2007	7.21%	6.62%	(0.95)%	.74%	6.46%
2005/2006	7.16%	7.61%	(4.28)%	.69%	4.69%
2004/2005	7.12%	7.48%	(7.10)%	.23%	4.23%

* Per 4% statutory minimum.

Reasons for Change in the Contribution Rate

• Change in normal rate	0.00%
• Decrease due to payroll reduction	(0.01)
• Decrease due to actuarial gain on assets	(2.25)
• Decrease due to actuarial gain on liabilities	(0.87)
• Increase due to change in health insurance contribution rate	0.07
• Increase due to effect of 4% floor on FY 2007 pension contribution	0.69
Total	(2.37)%

Reasons for Decrease Greater than Expected in Unfunded Accrued Liability

- Experience (Gains) Losses

— Gain from Investment Return on Actuarial Value of Assets	$(2,787,600,000)
— Gain from Salary Increases Less than Expected	(1,154,455,000)
— Gain from Retirement and Other Separation Experience	(42,170,000)
— Loss from Annuitants' Mortality Experience	113,484,000
Total	$(3,870,741,000)

* * * * * * * * * *

The Commission reviewed this report with Mr. Jeffrey Clay, Executive Director, Mr. Alan Van Noord, Chief Investment Officer, and Ms. Janet Cranna, Consulting Actuary, of the Public School Employees' Retirement System.

Summary of Actuarial Valuation
Public School Employees' Retirement System as of June 30, 2007

The following is a summary of the June 30, 2007, Actuarial Valuation of the Public School Employee's Retirement System and a comparison of the 2007 results with those of 2006.

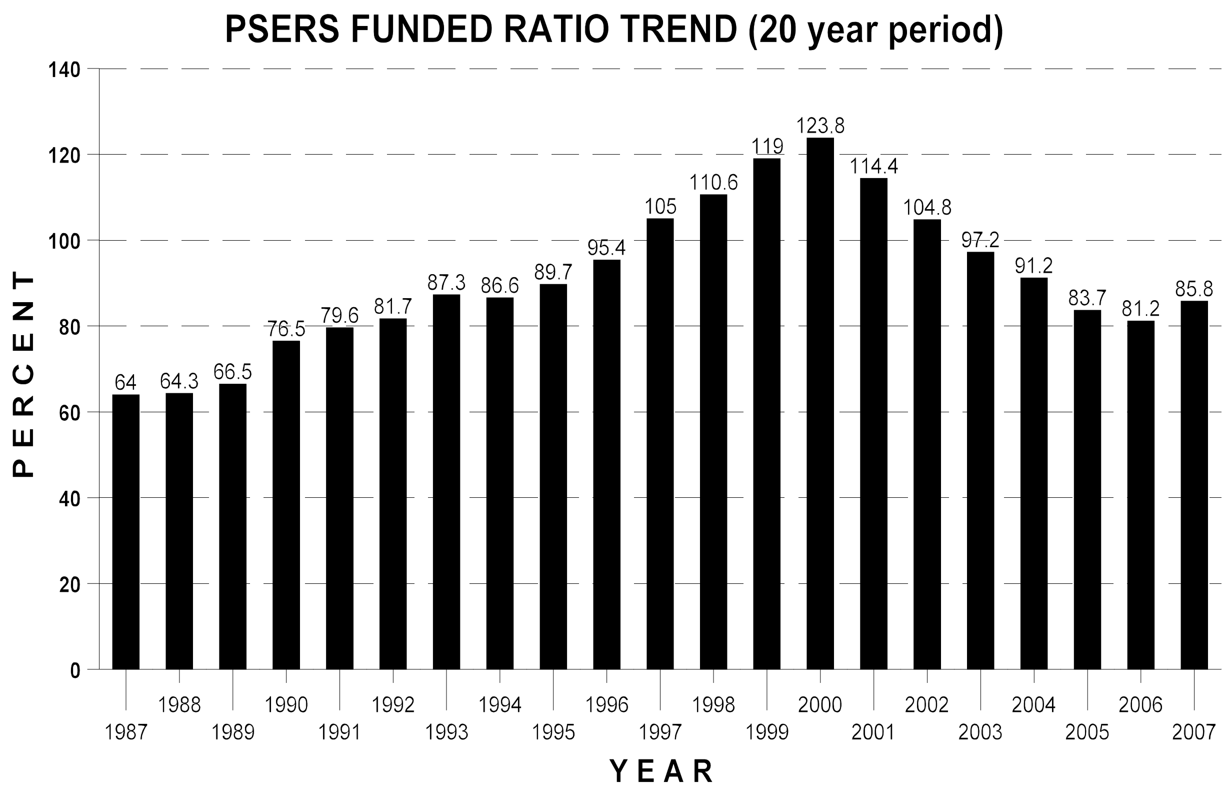
	6/30/06		6/30/07	
Membership				
Active Members	263,350		264,023	
Inactive and Vested Members	94,071		109,186	
Retired Members	146,582		152,361	
Disabled Members	7,175		7,399	
Survivors and Beneficiaries	8,056		8,266	
Payroll and Annuities Payable				
Total Annual Payroll	$11,419,049,000		$11,410,256,995	
Annual Annuities and Benefits	$ 3,274,451,000		$ 3,523,429,000	
Valuation Data				
Accrued Liability [1]	$64,720,138,000		$66,593,162,000	
Assets	52,557,503,000		57,155,130,000	
Unfunded Accrued Liability [1]	$12,162,635,000		$ 9,438,032,000	
Fund Ratio (Pensions and Health Insurance Combined)	81.2%		85.8%	
Funding Costs				
Normal Cost	$1,590,673,525.7	13.93 %	$1,594,012,900.00	13.97 %
Amortization [2]	(27,405,717.6)	(0.24)%	(384,525,660.73)	(3.37)%
Full Actuarial Funding	$1,563,267,808.1	13.69 %	$1,209,487,239.27	10.60 %
Support - Minimum [3]				
Member	Employer Pension Contribution Rate is above the minimum in Fiscal Year 2007-2008		Employer Pension Contribution Rate is at the minimum in Fiscal Year 2008-2009	
School District				
Commonwealth				
Total Support [4]				
Support - Adopted				
Member	$ 827,881,052.5	7.25%	$ 831,807,734.94	7.29%
School District	367,693,377.8	3.22%	271,564,116.48	2.38% [4]
Commonwealth	367,693,377.8	3.22%	271,564,116.48	2.38%
Total Support	$1,563,267,808.1	13.69%	$1,374,935,967.90	12.05%

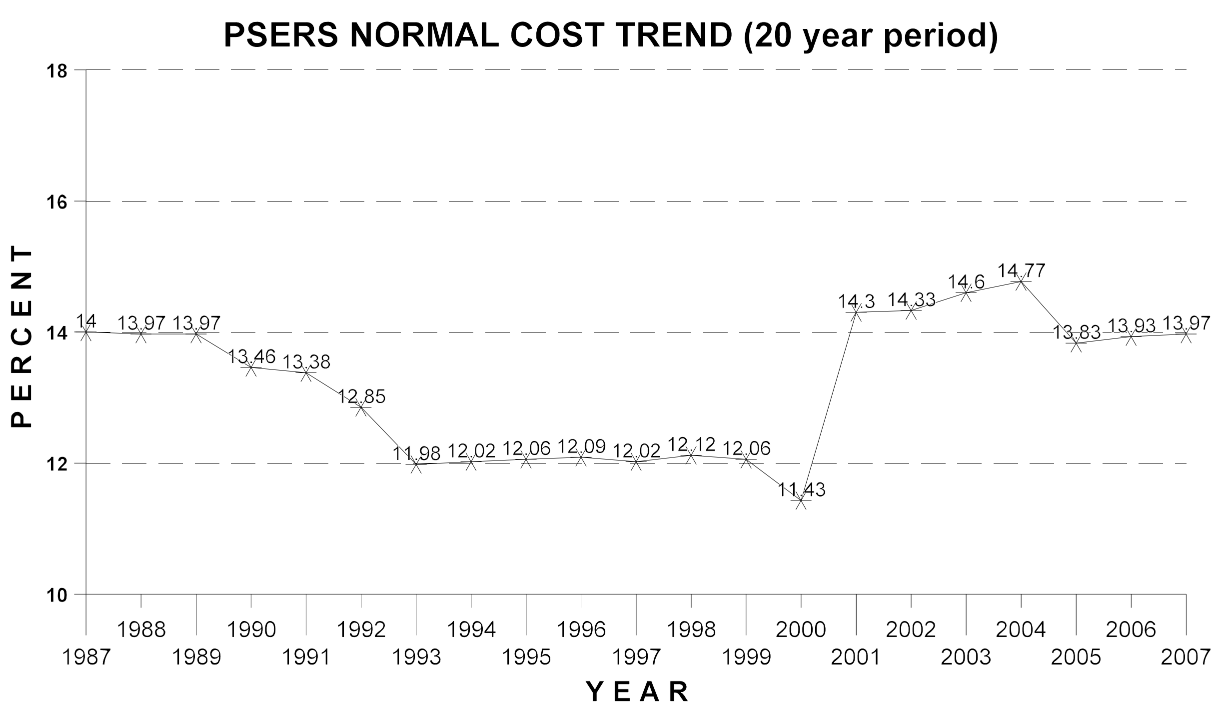
[1] Includes liability for health care payments.

[2] Act 40 of 2003 amended the actuarial cost method. The outstanding balance of the unfunded accrued liability (UAL) as of June 30, 2001, and the decrease in the UAL due to the actuarial asset method change provided by Act 38 continue to be amortized over a 10-year period, with level dollars, beginning July 1, 2002. The increases in the UAL due to the 7/1/02 and 7/1/03 cost-of-living adjustments continue to be amortized over a 10-year period, with level dollars, starting 7/1/03 and 7/1/04 respectively. All other changes in the UAL at 6/30/01, 6/30/02, and 6/30/03 – including Act 9 changes – are amortized over a 30-year period, with level dollars funding, starting on 7/1/02, 7/1/03 and 7/1/04 respectively. Future benefit improvements will be amortized over 10 years, level dollar funding. Future gains and losses will be amortized over 30 years, level dollar funding.

[3] Act 40 provides a 4.0% minimum employer pension contribution rate. The employer pension contribution rate in fiscal year 2007 would have been 3.31%, but for Act 40 and premium assistance contribution rate.

[4] The employer health-care contribution rate of 0.76% for Fiscal Year 2007-2008 is included in the total.


PSERS FUNDED RATIO TREND (20 year period)
PERCENT
140
120
100
80
60
40
20
0
64
64.3
66.5
76.5
79.6
81.7
87.3
86.6
89.7
95.4
105
110.6
119
123.8
114.4
104.8
97.2
91.2
83.7
81.2
85.8
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
YEAR


PSERS NORMAL COST TREND (20 year period)
PERCENT
18
16
14
12
10
14
13.97
13.97
13.46
13.38
12.85
11.98
12.02
12.06
12.09
12.02
12.12
12.06
11.43
14.3
14.33
14.6
14.77
13.83
13.93
13.97
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
YEAR

Commission's Review of the State Employees' Retirement System Actuarial Valuation Report

At the December 17, 2008, meeting of the Commission, the Staff presented a summary of the December 31, 2007, Actuarial Valuation Report of the State Employees' Retirement System (SERS) issued April 30, 2008, and reviewed some significant facts concerning the condition of the State Employees' Retirement System since the prior valuation.

General Discussion

- Funding Changes

  — The funding of the System (because of Act 8 of 2007) is 4.00 percent. The December 31, 2007, contribution before Act 8 would have been -1.15 percent.

Summary of Changes

- Changes in the December 31, 2007, valuation:

	Normal Cost	Unfunded Liability	Total
— Gain from investment earnings		- 3.63%	- 3.63%
— Other differences		0.77%	0.77%
— Pay increases different than assumptions		- 0.07%	- 0.07%
— Change in demographics of new entrants	0.21%	- 0.19%	0.02%
— Change in amortization due to change in payroll	0.00%	- 0.15%	- 0.15%
— Total Change	0.21%	-3.27%	-3.06%

- The following elements affected the amount of the unfunded liability:

— Gain from investment earnings	$(2,158,661,753)
— Other differences	468,497,239
— Pay increases different than assumptions	(43,448,200)
— Change in demographics of new entrants	(113,435,144)
— Total Change	$(1,847,047,858)
December 31, 2007, Unfunded Liability	$914,093,452

Employer Normal Cost Rate

- Normal Cost Rate for New Active Members:

— Superannuation and Withdrawal	12.49%
— Disability	1.23%
— Death	0.55%
— Refunds	0.40%
— Total	14.67%
— Member Contributions	6.25%
— Employer Normal Cost	8.42%

* * * * * * * * * *

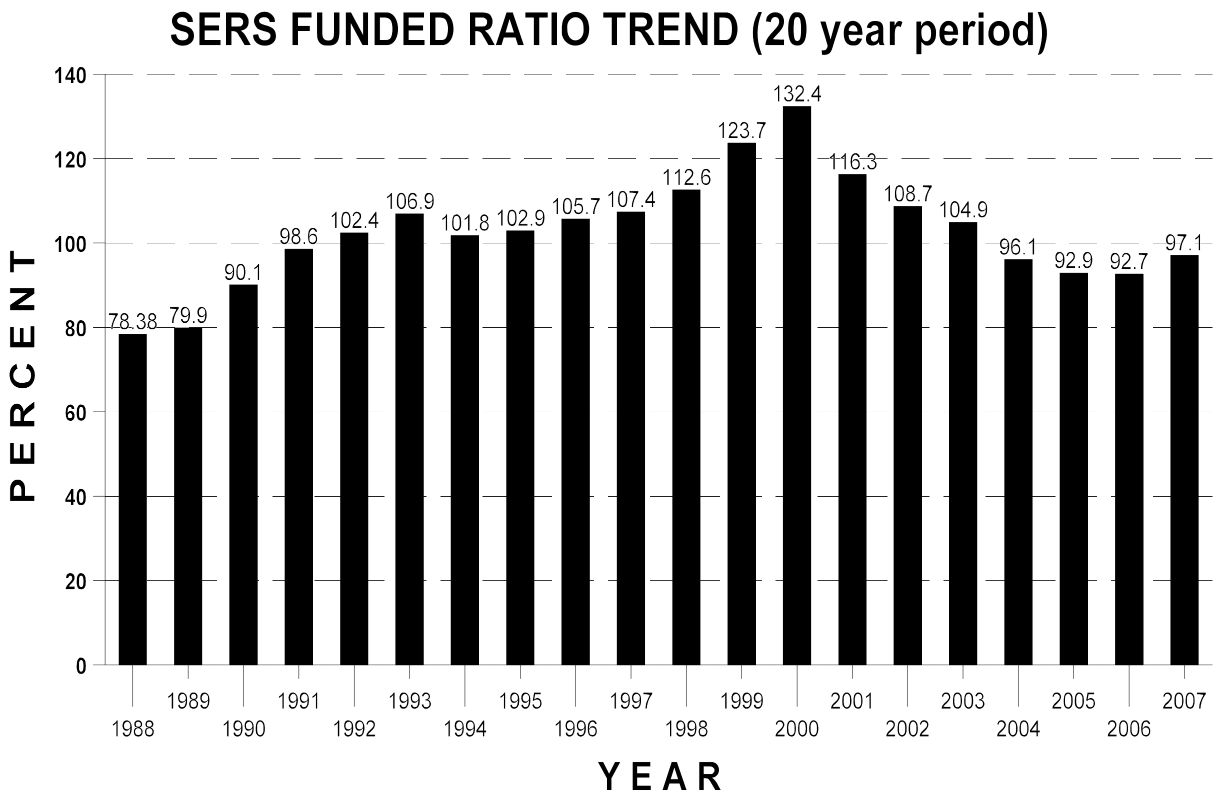
The Commission reviewed this report with Mr. Leonard Knepp, Executive Director, Mr. John Winchester, Chief Investment Officer, and Mr. Brent Mowery, Consulting Actuary, of the State Employees' Retirement System.

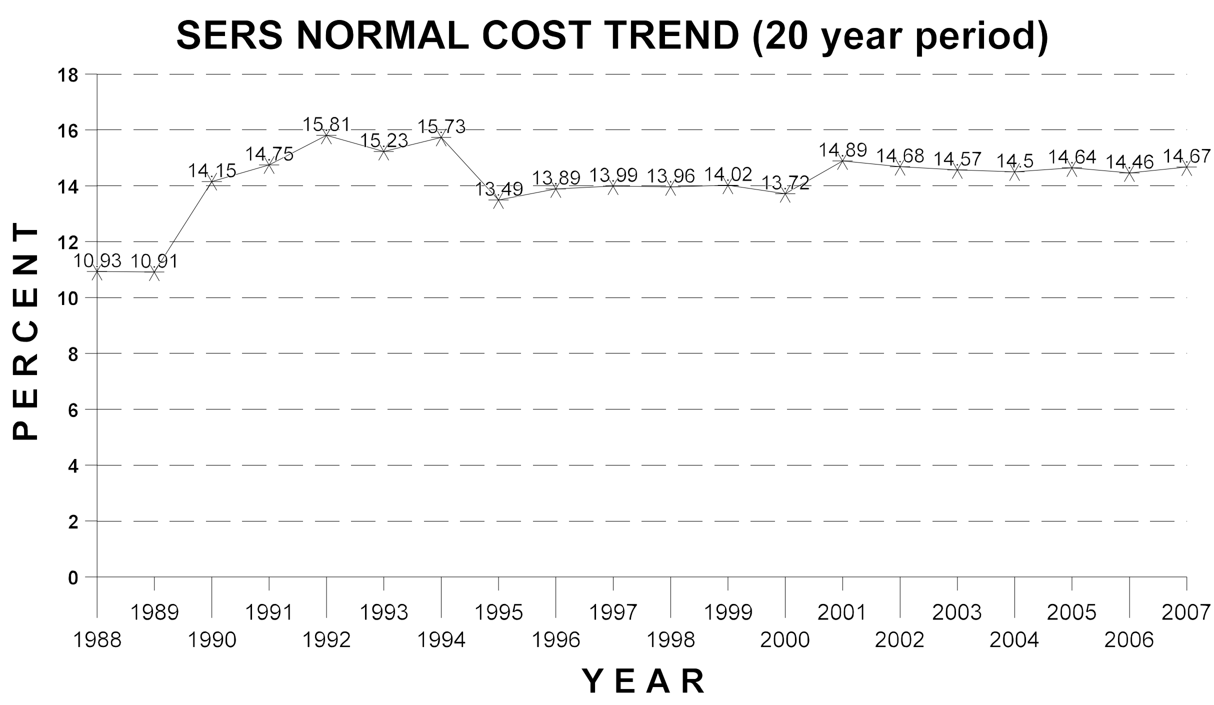
Summary of Actuarial Valuation
State Employees' Retirement System as of December 31, 2007

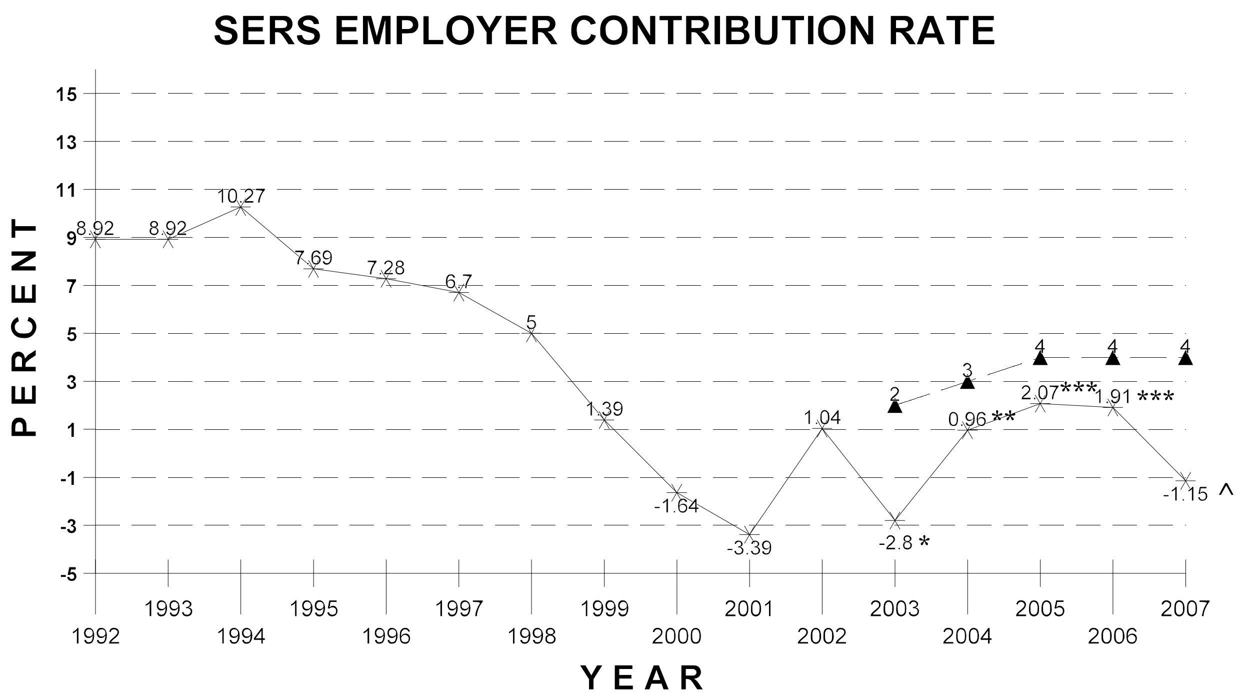
The following is a summary of the December 31, 2007, actuarial valuation of the State Employees' Retirement System and a comparison of the 2007 results with those of 2006.

	12/31/06		12/31/07	
Membership				
Active	110,972		109,610	
Inactive	5,843		5,692	
Retired	85,607		90,169	
Disabled	7,272		7,488	
Survivors and Beneficiaries	9,181		9,473	
Payroll and Annuities Payable				
Total Annual Payroll	$5,661,675,000		$5,529,069,000	
Annual Annuities and Benefits	$1,658,130,235		$1,849,310,873	
Valuation Data				
Accrued Liability	$30,364,996,561		$31,753,970,797	
Assets [1]	28,148,833,847		30,839,877,345	
Unfunded Accrued Liability	$ 2,216,162,714		$ 914,093,452	
Funded Ratio [2]	92.7%		97.1%	
Funding Costs				
Normal Cost [3]	$ 464,823,517.5	8.21 %	$ 465,547,609.8	8.42 %
Amortization [4]	$(356,685,525.0)	(6.30)%	$(529,131,903.3)	(9.57)%
Full Actuarial Funding	$ 108,137,992.5	1.91 %	$ (63,584,293.5)	(1.15)%
Support				
Member	$ 353,854,687.5	6.25%	$345,566,812.5	6.25%
Commonwealth	$ 226,467,000.0	4.00%	$221,162,760.0	4.00%
Total Support	$ 580,321,687.5	10.25%	$566,729,572.5	10.25%
Mandated Commonwealth Contribution [5]	$228,731,670.0	4.04%	$223,374,387.6	4.04%

1 The Assets figure is the actuarial value not the market value.
2 The Funded Ratio is based upon the actuarial value, not the market value, of assets and liabilities.
3 The State Employees' Retirement Code requires that the employer normal contribution rate be based on the level percentage of payroll normal cost determined under the entry age normal actuarial cost method for new members less the portion of the cost to be funded by member contributions.
4 The negative unfunded liability that existed before enactment of Act 9 is being recognized over a ten-year period beginning July 1, 2002. The liabilities for cost-of-living increases are being funded over ten-year periods from the July 1 following enactment of the increase. All other changes in liability are being funded over thirty-year periods from July 1 following the valuation that determined the change.
5 Act 8 of 2007 established minimum annual employer contribution level of 4 percent of payroll. The total Commonwealth support contribution for the SERS plan includes a .04% contribution for the Benefits Completion Plan.


SERS FUNDED RATIO TREND (20 year period)
PERCENT
140
120
100
80
60
40
20
0
78.38
79.9
90.1
98.6
102.4
106.9
101.8
102.9
105.7
107.4
112.6
123.7
132.4
116.3
108.7
104.9
96.1
92.9
92.7
97.1
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
YEAR


SERS NORMAL COST TREND (20 year period)
PERCENT
18
16
14
12
10
8
6
4
2
0
10.93
10.91
14.15
14.75
15.81
15.23
15.73
13.49
13.89
13.99
13.96
14.02
13.72
14.89
14.68
14.57
14.5
14.64
14.46
14.67
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
YEAR



* 2.00 percent mandated contribution per Act 40 of 2003.
** 3.00 percent mandated contribution per Act 40 of 2003.
*** 4.00 percent mandated contribution per Act 40 of 2003.
^ 4.00 percent mandated contribution per Act 8 of 2007.

APPENDICES

APPENDIX A

ADVISORY COMMITTEES AND CONSULTING ACTUARIES

Advisory Committees

Under Section 8 of the Public Employee Retirement Commission Act, the Commission appoints a Municipal Pension Advisory Committee and a Municipal Employee Pension Advisory Committee. Both advisory committees are appointed annually from nominations submitted by organizations of municipalities and municipal employees and meet with the Commission at least once each year to discuss the activities of the Commission and to present information or recommendations. The members of the advisory committees for calendar year 2008 and their sponsoring organizations were as follows:

MUNICIPAL PENSION ADVISORY COMMITTEE

Mr. Lee J. Janiczek
PENNSYLVANIA STATE ASSOCIATION OF TOWNSHIP COMMISSIONERS

Mr. A. Christopher Cap
PENNSYLVANIA STATE ASSOCIATION OF BOROUGHS

Ms. Amy C. Sturges
PENNSYLVANIA LEAGUE OF CITIES AND MUNICIPALITIES

Mr. Lester O. Houck
PENNSYLVANIA STATE ASSOCIATION OF TOWNSHIP SUPERVISORS

Mr. Gene Lee
COUNTY COMMISSIONERS ASSOCIATION OF PENNSYLVANIA

Mr. Joseph N. Sullivan
PENNSYLVANIA MUNICIPAL AUTHORITIES ASSOCIATION

MUNICIPAL EMPLOYEE PENSION ADVISORY COMMITTEE

Mr. David N. Eckman
PENNSYLVANIA PROFESSIONAL FIRE FIGHTERS' ASSOCIATION

Mr. Joseph Fitzgerald
PENNSYLVANIA FRATERNAL ORDER OF POLICE

Mr. William Dando
AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

Mr. Ronald Fonock
PENNSYLVANIA CHIEFS OF POLICE ASSOCIATION

Mr. Michael J. Crossey
PENNSYLVANIA STATE EDUCATION ASSOCIATION

ADVISORY COMMITTEES
AND CONSULTING ACTUARIES (Cont'd)

Consulting Actuaries

The actuarial services committee developed and adopted guidelines for providing actuarial services to the Commission on June 2, 1982. The guidelines establish the educational and experience standards for the selection of consulting actuaries. The engagement of multiple actuarial consultants was considered appropriate to provide the Commission with an enhanced scope of actuarial experience and a greater response capacity, and to avoid potential conflicts of interest. The actuarial consultants engaged by the Commission during 2008 were:

Conrad Siegel Actuaries
Mr. David H. Killick

Milliman, Inc.
Mr. William A. Reimert
Ms. Katherine A. Warren

Mercer Human Resource Consulting
Mr. Stephen T. McElhaney

APPENDIX B

LEGISLATIVE PROCEDURES UNDER SECTION 7 OF THE PUBLIC EMPLOYEE RETIREMENT COMMISSION ACT

I. Implementation by the General Assembly.

A. At the beginning of each legislative session of the General Assembly, the Speaker of the House and the President Pro Tempore of the Senate formally advise the chairmen of each standing committee in their respective chamber of the actuarial review provisions implemented by Act No. 1981-66.

B. Both chambers of the General Assembly adopt procedures most consistent with their operating rules to ensure that committee approved bills or floor amended bills are not considered prior to receipt of an actuarial note from the Commission or the passage of 20 legislative days from the date of first consideration or adoption of the floor amendment.

1. Actuarial Note Requests for Committee Approved Bills.-

   The Committee chairman in either chamber of the General Assembly shall notify the Commission upon reporting a bill to the floor which proposes any change relative to a public employee pension system and request preparation of an actuarial note.

2. Actuarial Note Requests for Floor Amended Bills.-

   The majority leader of either chamber of the General Assembly shall request preparation of an actuarial note for the floor amended bill on behalf of the respective chamber. The Commission shall provide the actuarial note as expeditiously as possible.

3. Actuarial Note Requests for Bills Referred by Other Chamber.-

   When a committee in either chamber of the General Assembly approves without amendment a bill to the floor which has had an actuarial note attached in the other chamber, preparation of a new actuarial note is unnecessary. Where an amendment to the bill has been approved by the committee, the chairman shall notify the Commission and request preparation of a new actuarial note. The Commission shall provide the actuarial note as expeditiously as possible.

4. Actuarial Note Requests from the House or Senate Appropriations Committees.-

   Whenever a request is received by the Commission from the chairman of either the House Appropriations Committee or the Senate Appropriations Committee for an actuarial note on a bill in the possession of the committee, the Commission shall formally authorize preparation of the actuarial note, as opposed to an advisory note, and transmit the actuarial note to the requesting committee as expeditiously as possible.

II. Response by the Commission.

A. The Commission acknowledges receipt of requests for the preparation of actuarial notes for committee approved bills and floor amended bills to the presiding officer of the requesting chamber of the General Assembly within 48 hours.

B. The Commission transmits the requested actuarial notes to the presiding officer of each chamber of the General Assembly as promptly as possible, recognizing that the 20 legislative days permitted for the preparation of actuarial notes is a maximum rather than a norm. Where there are no substantive actuarial or policy implications, the Commission will communicate that fact as the requested actuarial note.

C. The Commission provides copies of the transmittals of the requested actuarial notes to the following:

1. the chairman and minority chairman of the requesting committee;
2. the majority and minority leaders;
3. the majority and minority whips;
4. the majority and minority caucus chairmen;
5. the majority and minority appropriation committee chairmen;
6. the prime sponsor of the bill;
7. the Secretary of the Senate;
8. the Chief Clerk of the House; and
9. the Director of the Legislative Reference Bureau.

D. Upon the request of the committee chairman, the Commission staff may whenever possible provide supplemental reviews for bills prior to consideration by a committee. The information is transmitted to the committee chairman and minority chairman. Such assistance may contain actuarial data, but is considered to be an "advisory note" not constituting or substituting for the required actuarial note.

E. The Commission staff provides advice and counsel to members of the General Assembly on relevant matters pertaining to retirement plan design, financing, and administration.

F. The Commission provides actuarial notes or advisory notes only to appropriate officials of the legislative and executive branches.

G. The Commission transmits notice of its meetings to the Secretary of the Senate and Chief Clerk of the House for publication on the Senate and House daily meeting calendars.

Adopted April 10, 1985.

APPENDIX C

BY-LAWS OF THE
PUBLIC EMPLOYEE RETIREMENT COMMISSION

Title 4. Administration

Part XII. Public Employee Retirement Commission

Section 401.1. Definitions.

The following words and terms, when used in this part shall have the following meanings, unless the context clearly indicates otherwise:

Act - the act of July 9, 1981 (P. L. 208, No. 66), known as the "Public Employee Retirement Commission Act."

Advisory Committee - a municipal pension advisory committee established under the provisions of Section 8 of the Act.

Commission - the Public Employee Retirement Commission created under the Act.

Member - a member of the Commission.

Chapter 402. By-Laws

Section 402.1. Meetings

Meetings of the Commission shall be held as necessary at the call of the chairman, but in no case less than six times per year. Meetings shall be held on the dates and at the times and locations specified by the chairman in the notice of the meeting. Notices of meetings shall contain an itemized agenda in reasonable detail. Notice of meetings shall be given to all members in writing at least seven days prior thereto; provided that such notice may be given at least twenty-four hours prior to such meeting where deemed necessary by the chairman under the circumstances. The chairman shall call a meeting upon the request in writing of five or more members.

Section 402.2. Quorum and Voting.

Five members shall constitute a quorum for meetings. The majority vote of the members present at a meeting or otherwise entitled to vote pursuant to these By-Laws shall constitute official action of the Commission. In the event that one or more vacancy or long-term disability exists four members shall constitute a quorum. A Commission member who is a member of the Senate or House of Representatives of the Commonwealth of Pennsylvania may, from time to time, appoint a designee in writing. A designee may cast a vote for a member on any matter pending before the Commission relating to an agenda item; provided that the member has set forth in writing with reasonable particularity the position of the member on the agenda item and the vote of the designee is not inconsistent therewith. Otherwise, a member may only vote in person. The Commission may take official action on any matter properly before a meeting whether or not mentioned in the notice of the meeting.

Section 402.3. Open Meetings.

Meetings of the Commission shall be held and notice thereof shall be given in accordance to Act No. 1986-84 relating to public meetings, as applicable.

Section 402.4. Minutes.

Minutes shall be kept of all meetings of the Commission and shall be filed in the office of the Commission, subject to the Act of June 21, 1957 (P. L. 390) §§ 1-4, as amended, (65 P. S. §§ 66.1-66.4) relating to the inspection and copying of public records, as applicable.

Section 402.5. Officers.

The Commission shall annually elect a chairman, a vice-chairman and such other officers as it finds necessary or desirable at the first meeting of the Commission occurring in each calendar year. All such officers shall be members and shall serve until the election of a successor. Election shall also occur in the event of a vacancy in any office. The chairman shall preside over all meetings of the Commission at which he is present, or in his absence the vice-chairman, or in both of their absence a member chosen by the Commission. In the event that the Chairman is unable to act hereunder for any reason, the vice-chairman may do so.

Section 402.6. Office.

The Commission may establish an office for the use of the Commission in the conduct of its official business.

Section 402.7. Committees.

The Commission may, from time to time, establish such committees as it deems necessary or desirable in the conduct of its official business. Appointments to committees shall be made by the chairman. The term of each committee shall be coterminous with that of the chairman. For the purposes of this section, any liaison shall be deemed to be a committee.

Section 402.8. Advisory Committees.

The Commission shall appoint each advisory committee pursuant to the applicable law no later than the third meeting of the Commission occurring in each calendar year. The term of each advisory committee shall be for one calendar year or until the appointment of a successor, whichever occurs later.

Section 402.9. Budget.

The executive director of the Commission shall annually submit a proposed budget to the Commission for approval prior to the submission date under budget guidelines applicable to Commonwealth agencies.

Section 402.10. Miscellaneous.

The Commission may, from time to time, do such other things and take such other actions as it deems necessary or desirable in the conduct of its official business.

Section 402.11. Amendment.

The Commission may, from time to time, amend these By-Laws by majority vote of the members present at a meeting or otherwise entitled to vote pursuant to these By-Laws; provided that notice of the meeting shall have set forth at least the general nature of the amendment.

Revised November 17, 1987

APPENDIX E

CONCISE INDEX TO ACTUARIAL NOTES