PUBLIC EMPLOYEE RETIREMENT COMMISSION

2010 ANNUAL REPORT

Commonwealth of Pennsylvania

2010

Annual Report

of the

Public Employee Retirement Commission

Public Employee Retirement Commission
Commonwealth of Pennsylvania
February 2011

PUBLIC EMPLOYEE RETIREMENT COMMISSION

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COMMONWEALTH OF PENNSYLVANIA
PUBLIC EMPLOYEE RETIREMENT COMMISSION
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February 2011

To: Governor Corbett
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 2010.

During 2010, the Commission authorized the attachment of eight 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 2010 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-eighth 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 2010.

Sincerely,

Anthony W. Salomone
Chairman

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, an amount that exceeded $217 million in 2010.

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-fifth 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 2010.

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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 2010 ACTIVITY.

During 2010, the Commission authorized the attachment of eight 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. SYNOPSIS OF ADVISORY NOTE.

- <u>House Bill Number 2497, Printer's Number 4476, as amended by Amendment Number 09760</u>. At the request of Representative Stan Saylor, Republican Policy Chairman, on November 10, 2010, the Commission staff provided an advisory note on House Bill Number 2497, Printer's Number 4476, as amended by Amendment Number 09760. House Bill Number 2497, Printer's Number 4476, as amended by Amendment Number 09760, would amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code by mandating the establishment of reduced benefit tiers applicable to most new members of both the Public School Employees' Retirement System and the State Employees' Retirement System.

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 566, Printer's Number 577, as amended by Amendment Number 08034

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

Subject: Unified Contribution Pension Plan

SYNOPSIS

Senate Bill Number 566, Printer's Number 577, as amended by Amendment Number 08034, would amend Title 71 (State Government) by adding a new part, Part 27, titled "Unified Contribution Pension Plan." Chapter 71 of Part 27 would establish a new mandatory retirement system applicable to school and state employees hired after July 1, 2011. The new retirement system established by the bill as amended, known as the Public Employees' Retirement System (PERS), would be a defined contribution (DC) pension plan.

DISCUSSION

The Retirement Codes and Systems

Currently, most full-time public school and state employees are members of either the Public School Employees' Retirement System (PSERS) or the State Employees' Retirement System (SERS). Both PSERS and SERS are governmental, cost-sharing, multiple-employer defined benefit (DB) pension plans. The designated purpose of PSERS and SERS is to provide retirement allowances and other benefits, including disability and death benefits to public school and state employees. As of June 30, 2009, there were approximately 754 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS, and as of July 2009, there were approximately 107 participating state and other organizations in SERS.

Membership in the retirement 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, 2009, there were 279,701 active members and 177,963 annuitant members of PSERS, and as of December 31, 2009, there were 110,107 active members and 109,639 annuitant members of SERS.

For most members of both Systems, the basic benefit formula used to determine the normal retirement benefit is equivalent to the product of 2.5% multiplied by the member's years of accumulated service credit multiplied by the member's final average (highest three years) salary. Most members of PSERS are Class T-D members and contribute 7.5% of pay, while most members of SERS are Class AA members and contribute 6.25% of pay. Within both Systems, there are also a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school and state employees.

Under the Codes of both PSERS and SERS, superannuation or normal retirement age is that date on which a member may terminate service with the public employer and receive a full retirement benefit without reduction. 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 at least 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.

Defined Benefit and Defined Contribution Retirement Systems

There are two predominate approaches to pension plan design employed in the public and private sectors to provide employee retirement benefits. In a "defined benefit" (DB) plan, such as PSERS and SERS, the pension benefit to be provided at retirement is defined, while the contributions to be made over the period of employment are variable based on the experience of the pension fund. Upon retirement, a DB plan participant is entitled to receive a definitely determinable benefit that is calculated using a formulation that considers factors such as age, duration of service with the employer and compensation. Because the benefit is defined and calculated using a formula and is not dependent on an individual's account balance, members of DB plans are largely insulated from both negative and positive fluctuations of the investment markets.

By contrast, in a "defined contribution" (DC) pension plan, such as the PERS plan proposed in the bill as amended, the contributions to be made over the period of employment are defined, while the pension benefit to be provided at retirement is variable based on the experience of the pension fund. Upon retirement or separation from the employer, a DC plan participant is generally entitled only to the balance standing to the credit of the individual's retirement account. Market performance directly impacts the value of an individual's retirement account.

The distinction between the DB and DC approaches is most significant in the placement of the risk associated with investment earnings over the period of employment. The fixed benefit in a DB pension plan means that the investment experience impacts the contribution requirements, increasing them when investment earnings are lower than anticipated and decreasing them when earnings are greater than anticipated. The fixed contributions in a DC pension plan mean that the investment experience impacts on the benefit amount, increasing it when earnings are higher and reducing it when earnings are lower. Therefore, the employer bears the investment risk in a DB plan, and the employee bears the investment risk in a DC pension plan.

For most employees, defined contribution plans are generally regarded as more valuable for those in the early stages of their careers or for those who are employed in careers that require greater mobility. Defined contribution accounts are portable and can readily move with the employee as that employee moves from one employer to the next. In contrast, defined benefit plans are relatively more valuable for those employees who tend to remain with one employer and to long-service employees in the later stages of their careers, because the value and cost of the defined benefits earned each year increase significantly as employees approach retirement age.

Public Employees' Retirement System (PERS)

The bill as amended would establish a new mandatory retirement system applicable to all public employees hired by school or State employers within the Commonwealth after July 1, 2011. The new retirement system, known as the Public Employees' Retirement System (PERS), would replace the defined benefit plans provided by PSERS and SERS with a defined contribution retirement plan. Membership in both PSERS and SERS would be closed to new entrants effective July 1, 2011. Current members of PSERS and SERS would retain membership in those Systems.

If enacted, the bill as amended would create an entirely new public employee retirement system, eventually replacing both the traditional defined benefit plans currently provided by PSERS and SERS with a single defined contribution plan applicable to all school and state employees. The bill as amended requires the creation of a new governmental entity, which is a major undertaking, with all of the costs and complexities associated with the creation of any new governmental institution. The creation of this new, statewide pubic employee retirement system, known as PERS, presents a range of fairly complex issues that require careful consideration. For the purposes of the Commission's discussion, the major issues have been divided into the following four categories: 1) establishment, organization and operation; 2) coverage, benefits and contributions; 3) investments; and 4) ancillary issues.

Establishment, Organization and Operation

The bill as amended mandates the creation of PERS, establishes the PERS Board, and sets forth the Board's composition, powers and duties, including staffing, contracting with vendors and funding of operations. Most of the details governing the actual operation of PERS are delegated to the PERS Board which will be responsible for establishing the rules and regulations governing the System. These rules and regulations will presumably address the many specific details involved in the operation of a public pension system, such as the collection of contributions, investment options, benefit payment methods, domestic relations orders, beneficiary designations, etc. It also appears that most of the new System's investment and administrative functions will be handled by third-party administrators contracted by the Board to provide the necessary services.

The bill as amended is unclear on how the administrative expenses of PERS are to be funded. Under Section 7105(f), the PERS Board will be required to submit an annual budget to the General Assembly for the administrative expenses of the System. The approved expenses are to be paid "in whole or in part" from member "nonvested forfeitures" (a term which is not defined) in PERS, and reference is also made to the payment of directed commissions by the board. Section 7108 states that, "all other expenses arising from the administration of the system," are to be paid from the individual retirement accounts of active members of the System.

The creation of a large governmental institution such as PERS will be costly. Because PERS will initially have no assets and few members, it seems likely that the current funding process provided for in the bill as amended will prove insufficient, at least in the early years of operation. It appears likely that appropriations, either from the Commonwealth General Fund or some other source identified and authorized by the General Assembly, will be necessary to meet the initial and ongoing annual administrative funding requirements of PERS.

Coverage, Benefits and Contributions

Section 7101 sets forth the intent of the proposal in the bill as amended, which is to preserve the long-term fiscal stability of the Commonwealth and "school districts" by replacing the defined benefit plans provided through PSERS and SERS, with a single, unified, tax-qualified, defined contribution retirement system for all employees of the Commonwealth and "school districts." Although the bill as amended makes specific reference to the employees of school districts, Section 7102 defines the terms "public employee," "state employee," "school employee," and "public school" more broadly. Together, these new definitions function to encompass the employees and officials of nearly all school employers including state-owned educational institutions, community colleges and the Pennsylvania State University. Nearly all Commonwealth employers, including the General Assembly, the judiciary and many independent or quasi-independent governmental employers are included as well. Membership in PERS would be mandatory for all such employees newly entering service.

The treatment of former members of SERS and PSERS (vestees, inactive members and annuitants) who return to public service following a break in service is not clear. Section 7115(d) seems to indicate that membership in PERS would be mandatory only for those employees who enter into public service, "for the first time after July 1, 2011." Likewise, Section 7117(1) indicates that PERS membership would not be mandatory for any employee who is employed prior to July 1, 2011. However, Section 7117(2) of the bill as amended contains the contradictory and confusing requirement that this chapter, "shall apply to any person who is a public school employee or state employee before July 1, 2011, and who is not a public employee on July 1, 2011, *but reenters public service after July 1, 2011."*

There is also a conflict with respect to the effective dates applicable to mandatory membership in PERS. In Section 7102 under the definition of "public employee," membership in PERS would be mandatory *after November 30, 2011*. However, throughout the bill, an effective date beginning after July 1, 2011, is also used. For the purposes of the Commission's discussion, it has been assumed that the November 30, 2011, date is a drafting oversight and that the date of *after July 1, 2011*, is the effective date intended by the sponsors of the proposal.

Clearly, by mandating participation in PERS for new hires only, it is the intent of the sponsors of the bill as amended to avoid impairing the retirement benefit rights of current PSERS & SERS members. It has been well-established that in the Commonwealth, public employee retirement benefits are recognized as deferred compensation for work already performed, which confers upon public employees certain contractual rights protected by the Pennsylvania Constitution (Article I, Section 17). *Police Officers of Hatboro v. Borough of Hatboro,* 559 A.2d 113 (Pa. Cmwlth 1989); *McKenna v. State Employees' Retirement Board,* 495 Pa. 324, 433 A.2d 871 (1981); *Catania v. State Employees' Retirement Board,* 498 Pa. 684, 450 A.2d (1982). These contractual pension rights become fixed upon the employee's entry into the retirement System and cannot be unilaterally diminished or adversely affected, regardless of whether (1) the member is vested; or (2) the devaluation is necessary for actuarial soundness. *Association of Pa. State College and University Faculties v. State System of Higher Education,* 505 Pa. 369, 479 A.2d 962 (1984). See also *Hughes v. Public School Employees' Retirement Board*, 662 A.2d 701 (Pa. Cmwlth. 1995), *alloc. denied,* 542 Pa. 678, 668 A.2d 1139 (1995) (member has property interest in pension benefit).

The PERS plan is a defined contribution pension plan. The language in the bill as amended is unclear as to whether member contributions to the plan are mandatory or voluntary. Section 7111 seems to indicate that member contributions are mandatory by stating that "regular active member contributions shall be made to the System on behalf of each active member," and that the employer "shall cause active member contributions for current service to be made." However, later in the section it is stated that active members "*may* elect to contribute to the system on their behalf." Members may make contributions to PERS on their own behalf to the extent permitted by law, with a dollar-for-dollar employer-matching contribution of up to 6% of the member's "pensionable earnings," as that term is defined in Section 7102 (which excludes overtime compensation and bonuses). Mandatory participation in a defined contribution pension plan normally involves a minimum employee contribution requirement. The bill as amended does not set a minimum participant contribution rate for either the member or the employer, which could mean that members may choose to contribute nothing, and likewise, the employer would also make no contributions toward the member's retirement plan. The purpose of mandating participation in a pension plan when no minimum contribution to the plan is required is not apparent. Further, there may be serious tax-qualification issues involved with such an approach. Based on the Commission's understanding of the IRC tax-qualification rules, employee contributions to a defined contribution plan sponsored by a governmental entity can only be made on a pre-tax basis if plan membership is mandatory or there is a one-time irrevocable salary reduction agreement in place. Finally, the apparently optional nature of plan participation is contradicted in Section 7106(d) which mandates a default investment option provision applicable to members who do not elect one and requiring that "the active member contribution in the default investment option shall be 6% of the active member's pensionable earnings."

Members of PERS would become fully vested in the employer contribution portion of the plan after three years of service. Presumably, non-vestees who terminate service prior to vesting would be entitled to a return of their own contributions to the plan, however, there is no specific provision for this contingency, beyond a somewhat vague reference to the return of "accumulated deductions" (a term which is not defined) in Section 7115(f). Section 7113(b)(2) requires the forfeiture of the employer contribution portion of a non-vested member's account upon the death, "or other termination of public service of the active member," and permit the forfeited balance of any such account to be used to defray the administrative expenses of PERS under Section 7105(f).

Under current law, "school employees" (employees of the Pennsylvania State System of High Education (PASSHE) institutions, most employees of the Pennsylvania State University, and community college employees) are eligible to choose coverage in an employer-approved, defined contribution "alternative retirement program" as an alternative option to membership in either the State Employees' Retirement System (SERS) or the Public School Employees' Retirement System (PSERS).

The purpose is to permit eligible employees the option of participating in a defined contribution plan similar to those commonly available to other college and university employees throughout the U.S. Section 5301(a)(12) of the SERS Code allows employers to contribute up to 9.29% of pay into the independent retirement program, and all affected employers currently contribute at that rate. The maximum employer contribution rate of 9.29% for an independent retirement program was selected so that the value of the benefits provided by it would be comparable to the value of the benefits provided by SERS to the average state employee over the course of that employee's career in public service. The Teachers' Insurance and Annuity Association of America - College Retirement Equities Fund (TIAA-CREF) is the best known, oldest, and largest of the defined contribution plans in the field of education, and from 1982 until 2001, was the only vendor permitted to be approved by the affected employers as an alternative retirement plan. With the passage of Act 35 of 2001, the number of potential, alternative retirement program vendors available to higher education institution employees was expanded to include insurance companies and mutual fund companies with investment options meeting the requirements of a tax-qualified plan under the Internal Revenue Code. As of October 1, 2008, the following vendors were approved as qualified alternative retirement plans for PASSHE employees: TIAA-CREF, AIG Retirement, ING and Fidelity; with all but a small minority of employees electing TIAA-CREF as their alternative retirement program vendor.

With the passage of the bill as amended, it appears that new employees of these educational institutions would no longer have the option to select membership in an alternative retirement program such as TIAA-CREF. Beyond reducing employer costs associated with active member benefits, the rationale for mandating replacement of a well-established defined contribution plan (such as TIAA-CREF) with a new defined contribution plan providing a benefit of lesser value is unclear. Because the maximum employer contribution on behalf of active members would be limited to 6% under PERS, members of PERS will be entitled to a retirement benefit of lesser value relative to their colleagues who are members of an alternative retirement program such as TIAA-CREF. The reduced benefits available to new employees would create a retirement benefit disparity between similarly situated educational employees who are required to become members of PERS and those employees still covered by TIAA-CREF and other authorized alternative retirement program vendors.

Within SERS, there are a number of special membership classes entitled to enhanced retirement benefits, reduced superannuation requirements or both. These include all members of the judiciary, members of the General Assembly, 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 as amended, there would be no special benefit provisions for these groups of employees.

In 1974, an attempt was made to reform and make uniform the benefit provisions of the SERS Code. This attempt at reform prompted a series of lawsuits brought by members of the judiciary challenging the benefit changes as applied to members of the judicial branch. These court cases ultimately resulted in the preservation of the judiciary's entitlement to special membership status and enhanced benefits. The most salient of these cases were the "Goodheart" Supreme Court decisions (See *Goodheart v. Casey*, 521 Pa. 316 (1989); 523 Pa. 188 (1989), and *Klein v. State*

Employees' Retirement System, 521 Pa. 330, 555 A.2d 1216, 1221 (1989)). Essentially, the Supreme Court of Pennsylvania ruled that the 1974 amendments to the Code, which eliminated the option to elect special class membership, were unconstitutional as applied to members of the judiciary. The Supreme Court ruled that, in order to preserve an independent judiciary, judges must be adequately compensated, pension benefits are part of compensation, and all members of a single-level court performing similar functions and exercising similar authority must be compensated at the same rate. As a result, all individuals who became members of the judiciary following the 1974 amendments to the SERS Code must be permitted to elect special class (Class E-1 or E-2) membership, make the required higher member contributions, and receive the higher pension benefit attributable to their membership class.

Based upon the independent status of the judiciary in Pennsylvania and the case law regarding the special status of its members, if enacted, the bill as amended would almost certainly be challenged in the courts.

Both the PSERS and SERS Codes include provisions exempting the use of collective bargaining agreements or arbitration awards between the Commonwealth and its employees pertaining to pension or retirement benefit rights of employees. The bill as amended includes no provision precluding the use of collective bargaining agreements or arbitration awards for the purpose of providing employee pension benefits. The bill's sponsors may wish to consider the effect that the absence of such a provision may have on PERS, when the intent of creating a new reduced benefit DC plan is apparently to control retirement benefit costs.

SERS members who are Pennsylvania State Police Officers now are granted special retirement rights and benefits such as superannuation at an earlier age with fewer mandatory years of service. The retirement age for most public safety employees is age 50, primarily due to the hazardous nature and physical demands of public safety work. In PERS, there are no special benefit provisions for public safety employees. By election of the Commonwealth, State Police Officers do not participate in Social Security old-age or disability benefits, and are subject to a mandatory retirement age of age 60 with 20 years of service (§205 of the Administrative code of 1929). If the bill as amended is enacted, the Commonwealth may find difficulty in recruiting and retaining State Police members, particularly when those members will be earning benefits that are less than other PERS members.

The bill as amended contains disability benefit provisions that are unclear. First, no standard of disability has been established (permanent or temporary). The employer is to continue matching contributions in the event of disability at the same rate that was provided before the disability occurred (Section 7112(b)). Additionally, contributions are to continue until the member attains age 65. There is no provision to cease the contribution prior to age 65 if the member is no longer disabled. If contributions are to cease, a provision for monitoring the status of disabled members through periodic medical review would need to be established. There is also no provision for a Workers' Compensation offset in the case of a member who is injured on the job.

Beyond payment of the member's account balance to the designated beneficiary upon the death of an active member, there are no special death benefit provisions to provide for the surviving spouse or children of a PERS member. The bill's sponsors may wish to consider whether the absence of any special disability benefits for members of PERS could interfere with recruiting and retaining employees, particularly hazardous duty personnel who may be exposed to a higher risk of injury in service.

Under PERS, the maximum employer contribution is 6% of compensation. Currently, the employer normal cost rate for both PSERS and SERS is greater than 6% of compensation. Therefore, the value of the employer-provided benefits to the new PERS members will generally be lower than the employer-provided benefits provided to current PSERS and SERS members.

Investments

Members of PERS will be provided with a variety of investment options, including lifestyle funds that are based upon age and projected retirement date. PERS will also make available investment options that represent a broad cross-section of asset classes and risk profiles, including low-cost investment alternatives. A composite fund may also be offered to participants which represents the entire portfolio return under management within PSERS or SERS. If an active member does not select a specific investment option, PERS will provide a default investment option that will be the lifestyle fund which most closely represents the current demographic of the active member and the projected retirement date of the active member.

The PERS Board will designate a third-party administrator to run the daily operations of the new retirement system. The third-party administrator will be responsible for providing investment guidance to members in accordance with pension industry standards, along with online administration and daily valuations of the member's account.

The PERS Board will not be held responsible for any investment losses incurred by members in the System or for the failure of any investment to earn a specific or expected return. The board will bear the expenses arising from allowing public employee participation in the System and for contribution deductions to the fund managers. All other expenses from the administration of the System will be assessed against the accounts created on behalf of active members, either by the fund managers or by the board.

Because PERS will be a governmental plan, not subject to the Employee Retirement Income Security Act (ERISA), there is no fiduciary standard to which PERS or the third-party administrator can be held. This may unduly jeopardize the retirement security of members subject to PERS.

Ancillary Issues

*Retired Employee Health Program***.** The Retired Employee Health program (REHP) is administered jointly by the Governor's Office of Administration and SERS. The REHP provides for Commonwealth-subsidized post-retirement healthcare benefits to employees of most Commonwealth agencies. Eligibility for these benefits is tied to an employee's years of credited service in SERS and an employee's age at retirement. It is unclear how or if REHP participation would be incorporated into the PERS plan.

Pension Forfeiture Act. Under Act 140 of 1978, known as the Public Employee Pension Forfeiture Act (43 P.S. §§ 1311-1315), a public official or public employee who is convicted or pleads guilty or no defense to a crime related to public office or public employment is disqualified to receive a retirement or other benefit or payment of any kind except a return without interest of the contributions paid into a retirement system.

Because ownership of the funds vests immediately with the employee at the time of contribution under a defined contribution plan, it is unclear to what extent the Public Employee Pension Forfeiture Act would apply to the individual retirement accounts of PERS members.

Closure of PSERS and SERS to New Members

As noted previously, membership in PSERS and SERS would be closed to public employees hired by school or State employers within the Commonwealth after July 1, 2011. However, both retirement Systems will retain their current active and annuitant populations and funding for the retirement benefits of those members will continue for many decades. In actuarial terms, the funding dynamics of such "closed groups" differ significantly from an open group in which there is a continuous influx of new active members. Closed groups present funding challenges that will need to be addressed in the future through modification of the Systems' respective statutory funding provisions.

When the population of a retirement system is an open group, with a continuous influx of new active members, payroll generally increases and the level-dollar amortization represents a decreasing percentage of payroll. However, in a closed group, the payroll will begin shrinking in the future and the level-dollar payments will represent an increasingly larger percentage of payroll. Each System currently has a large unfunded actuarial accrued liability that will need to be covered by future contributions. The liabilities of PSERS and SERS are not unlike a home mortgage or other long-term debt. The debt must be paid (amortized), with interest, over a certain span of time. In the event PSERS and SERS are closed to new members, the period over which these liabilities will need to be amortized will be no more than 30 years on a level-dollar basis. The fixed-dollar cost of paying down these liabilities will result in large increases in amortization payments as a percentage of payrolls and may become excessively burdensome for the remaining active member employers.

Currently, changes in the unfunded accrued liability, except those due to legislative action, are amortized on a level-dollar basis over a 30-year period. Changes due to legislative action are to be amortized over a 10-year period. As the active membership declines within each System, it may not be reasonable to assume that future changes in the unfunded accrued liability should be amortized over 30 years. A ten-year period may also be unreasonable for future legislative changes. Consideration should also be given to the appropriate period over which future plan experience should be amortized.

Section 8328 of the PSERS Code and Section 5508 of the SERS Code specify methods to be used by the actuaries of the respective Systems to determine the "employer normal contribution rate" or employer normal cost and the total employer contribution rate, which consists of both the normal cost and the contributions required to fund the accrued liabilities of each plan, plus any amortization contribution requirement.

Both the PSERS and SERS Codes require the normal cost to be determined using "... a level percentage of the compensation of the average new active member...." However, the Systems apply different interpretations to the language. Using the SERS interpretation, the average new member, or entrant, to the System currently earns a benefit at the 2.5% annual accrual rate (Class AA members). The traditional method would be to develop the normal cost rate based upon current active members and the benefits to which each member is entitled. This method would be based upon a blending of accrual rates attributable to all active members, rather than new entrants only, and would result in a normal cost calculation that more closely approximates the normal costs of the Systems. According to the Commission's consulting actuary, PSERS is currently using the traditional normal cost method.

If the bill as amended is enacted, there would no longer be new members entering PSERS or SERS on which to determine the normal cost rate. The estimated actuarial cost for SERS for this actuarial note was determined assuming the normal cost rate would remain at the current level employing a "virtual" active member population. The Commission's consulting actuary believes that the SERS' method is reasonable. The Commission's consulting actuary has also indicated that the PSERS' method would be the preferred approach for determining the normal cost. Whichever method is chosen, it will require separate legislation and should be applied uniformly.

Once active membership in PSERS and SERS has significantly declined and retired members are the majority of each System's total membership, the Systems may also need to consider revising their investment policies. Due to the need to ensure sufficient liquidity to provide for the payment of benefits, both PSERS and SERS may be compelled to invest assets in a more conservative manner resulting in a lower discount rate. This revision would result in a lower valuation interest rate, which would result in higher actuarial accrued liabilities, requiring larger employer contributions as a percentage of payroll.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill as amended and the actuarial cost estimates provided to the Commission by the consulting actuaries for both PSERS and SERS. The results of these analyses are summarized in the following tables.

Table 1 shows the employer contribution rate and the employer contribution amount for school employers for FY 2011 to FY 2042 under (1) current law and (2) if the proposal in the bill as amended were enacted with a declining amortization period beginning in FY 2014. The appropriation payroll applicable to PSERS and PERS and the employer contribution change due to the bill as amended is also shown. Table 2 shows the employer contribution rate and the employer contribution amount for state (non-school) employers for FY 2011 to FY 2042 under (1) current law and (2) if the bill as amended were enacted with a declining amortization period beginning in FY 2012. The appropriation payroll applicable to SERS and PERS and the employer contribution change due to this amended bill is also shown.

As shown in Tables 1 and 2, the anticipated spike in the employer contribution rate in FY 2013 would still occur if the bill as amended were enacted. Based on the projection's lower normal cost attributable to new members entering PERS, there would be a reduced employer contribution requirement beginning in FY 2019 for PSERS employers and in FY 2012 for SERS employers.

Some of the reasons that SERS employers would realize immediate savings whereas PSERS employers would have additional short-term costs is the delay between the valuation date and the fiscal year for which the valuation determines contributions, the basis for the normal cost rate, the value of the benefits the normal cost rate represents, and when the bill as amended would be reflected in the System's valuation.

For SERS, the December 31, 2010, valuation is the basis for the FY 2011-2012 employer contribution. The SERS cost estimate reflects that the bill as amended would be reflected in the December 31, 2010, valuation through a reduced appropriation payroll for FY 2011-2012. The normal cost rate for the FY 2011-12 is for members accruing benefits during this period. Therefore, a reduction in the benefits earned during this period would result in a reduction in the costs for this period.

For PSERS, the June 30, 2010, valuation is the basis for the FY 2011-2012 contribution. The normal cost rate paid in FY 2011-2012 is for members who are expected to accrue benefits between July 1, 2010, and June 30, 2011. Effectively, the value of benefits earned in this upcoming period is paid for one year later. Therefore, changing the value of benefits earned after June 30, 2011, would not impact the dollar amount of the contribution. Under the bill as amended, PSERS would be closed to new hires after July 1, 2011, so any change in the normal cost would not be reflected until the June 30, 2012, valuation, which determines the FY 2013-2014 employer contribution. However the DC plan contributions would begin in FY 2011-2012, resulting in higher short-term costs for school employers.

It should also be noted that PSERS has a lower employer normal cost rate than SERS so it takes longer for the savings of the DC plan to present themselves under PSERS than SERS. These projections assume each of the System's assets would earn 8% each year of the projection. As membership in SERS and PSERS becomes increasingly inactive in nature, a lower valuation interest rate may be more appropriate as the investment allocation may become more conservative.

TABLE 1

Public School Employees' Retirement System (PSERS) and Potential Public Employees' Retirement System (PERS) Projected Employer Contribution Rates and Amounts for School Employers for Fiscal Year 2011 to 2042

($ amounts in millions)

		Current Law		Senate Bill 566 as amended by Amendment 08034							
		PSERS		PSERS			PERS				
Fiscal Year Ending June 30	Total Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Total Employer Contribution	Increase/ (Decrease) Employer Contribution
2011	$13,510.0	8.22%	$1,110.5	$13,510.0	8.22%	$1,110.5	N/A	N/A	N/A	$1,110.5	$0.0
2012	13,920.9	10.59%	1,474.2	13,920.9	10.59%	1,474.2	$708.3	6.00%	$42.5	1,516.7	42.5
2013	14,345.3	29.22%	4,191.7	14,345.3	29.22%	4,191.7	1,405.3	6.00%	84.3	4,276.0	84.3
2014	14,797.7	32.09%	4,748.6	14,089.4	33.28%	4,688.9	2,095.7	6.00%	125.7	4,814.6	66.0
2015	15,280.1	33.60%	5,134.1	13,874.8	36.18%	5,019.9	2,800.6	6.00%	168.0	5,187.9	53.8
2016	15,794.5	33.27%	5,254.8	13,698.8	37.11%	5,083.6	3,517.0	6.00%	211.0	5,294.6	39.8
2017	16,341.3	32.74%	5,350.1	13,540.6	37.83%	5,122.4	4,225.7	6.00%	253.5	5,375.9	25.8
2018	16,926.7	32.06%	5,426.7	13,409.7	38.34%	5,141.3	4,946.2	6.00%	296.8	5,438.1	11.4
2019	17,557.7	31.27%	5,490.3	13,332.0	38.60%	5,146.1	5,699.3	6.00%	342.0	5,488.1	(2.2)
2020	18,232.1	30.42%	5,546.2	13,285.9	38.72%	5,144.3	6,490.0	6.00%	389.4	5,533.7	(12.5)
2021	18,948.0	29.56%	5,601.0	13,248.8	38.79%	5,139.2	7,332.4	6.00%	439.9	5,579.1	(21.9)
2022	19,703.2	28.75%	5,664.7	13,213.2	38.88%	5,137.3	8,217.4	6.00%	493.0	5,630.3	(34.4)
2023	20,493.7	27.95%	5,728.0	13,161.3	39.00%	5,132.9	9,152.6	6.00%	549.2	5,682.1	(45.9)
2024	21,321.5	27.18%	5,795.2	13,104.1	39.12%	5,126.3	10,146.9	6.00%	608.8	5,735.1	(60.1)
2025	22,185.0	26.44%	5,865.7	13,032.4	39.29%	5,120.4	11,209.5	6.00%	672.6	5,793.0	(72.7)
2026	23,081.8	25.74%	5,941.3	12,935.0	39.53%	5,113.2	12,349.7	6.00%	741.0	5,854.2	(87.1)
2027	24,006.8	25.05%	6,013.7	12,797.3	39.86%	5,101.0	13,563.0	6.00%	813.8	5,914.8	(98.9)
2028	24,958.6	24.40%	6,089.9	12,608.9	40.33%	5,085.2	14,851.7	6.00%	891.1	5,976.3	(113.6)
2029	25,937.5	23.78%	6,167.9	12,374.4	40.93%	5,064.8	16,217.0	6.00%	973.0	6,037.8	(130.1)
2030	26,944.0	23.19%	6,248.3	12,092.3	41.69%	5,041.3	17,666.8	6.00%	1,060.0	6,101.3	(147.0)
2031	27,978.1	22.63%	6,331.4	11,761.0	42.63%	5,013.7	19,210.2	6.00%	1,152.6	6,166.3	(165.1)
2032	29,041.5	22.10%	6,418.2	11,374.7	43.80%	4,982.1	20,839.2	6.00%	1,250.4	6,232.5	(185.7)
2033	30,136.5	19.46%	5,864.6	10,926.3	39.37%	4,301.7	22,553.5	6.00%	1,353.2	5,654.9	(209.7)
2034	31,268.4	18.16%	5,678.3	10,429.2	38.23%	3,987.1	24,349.3	6.00%	1,461.0	5,448.1	(230.2)
2035	32,446.3	16.82%	5,457.5	9,892.8	36.67%	3,627.7	26,233.4	6.00%	1,574.0	5,201.7	(255.8)
2036	33,675.8	15.65%	5,270.3	9,326.5	35.38%	3,299.7	28,211.7	6.00%	1,692.7	4,992.4	(277.9)
2037	34,956.6	14.33%	5,009.3	8,723.2	33.07%	2,884.7	30,274.0	6.00%	1,816.4	4,701.1	(308.2)
2038	36,292.1	13.88%	5,037.3	8,080.4	34.06%	2,752.2	32,431.4	6.00%	1,945.9	4,698.1	(339.2)
2039	37,690.6	14.64%	5,517.9	7,416.6	41.37%	3,068.3	34,680.3	6.00%	2,080.8	5,149.1	(368.8)
2040	39,153.0	14.47%	5,665.4	6,721.6	45.26%	3,042.2	36,998.6	6.00%	2,219.9	5,262.1	(403.3)
2041	40,680.0	13.15%	5,349.4	5,999.7	42.39%	2,543.3	39,444.9	6.00%	2,366.7	4,910.0	(439.4)
2042	42,266.6	12.18%	5,148.1	5,268.1	40.92%	2,155.7	42,025.7	6.00%	2,521.5	4,677.2	(470.9)
Total:			$169,590.6			$134,842.9			$30,590.7	$165,433.6	($4,157.0)

TABLE 2

State Employees' Retirement System (SERS) and Potential Public Employees' Retirement System (PERS) Projected Employer Contribution Rates and Amounts for State (non-school) Employers for Fiscal Year 2011 to 2042

($ amounts in millions)

		Current Law		Senate Bill 566 as amended by Amendment 08034							
		SERS		SERS			PERS				
Fiscal Year Ending June 30	Total Appropr-iation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropr-iation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropr-iation Payroll	Employer Contribution Rate	Employer Contribution Amount	Total Employer Contribution	Increase/ (Decrease) Employer Contribution
2011	$5,936.0	5.64%	$335.0	$5,936.0	5.64%	$335.0	N/A	N/A	N/A	$335.0	$0.0
2012	6,131.9	7.98%	489.0	6,024.3	7.95%	478.8	$107.5	6.00%	$6.5	485.3	(3.7)
2013	6,334.2	26.66%	1,688.4	5,941.2	27.79%	1,651.2	393.0	6.00%	23.6	1,674.8	(13.6)
2014	6,543.3	29.22%	1,911.7	5,829.9	31.66%	1,845.6	713.3	6.00%	42.8	1,888.4	(23.3)
2015	6,759.2	27.72%	1,873.5	5,705.1	31.06%	1,771.9	1,054.1	6.00%	63.2	1,835.1	(38.4)
2016	6,982.2	27.46%	1,917.0	5,565.9	31.96%	1,778.8	1,416.3	6.00%	85.0	1,863.8	(53.2)
2017	7,212.7	27.09%	1,953.9	5,406.8	32.85%	1,776.0	1,805.8	6.00%	108.3	1,884.3	(69.6)
2018	7,450.7	26.64%	1,985.2	5,240.5	33.70%	1,765.9	2,210.2	6.00%	132.6	1,898.5	(86.7)
2019	7,696.5	26.16%	2,013.4	5,068.2	34.55%	1,751.1	2,628.3	6.00%	157.7	1,908.8	(104.6)
2020	7,950.5	25.69%	2,042.1	4,892.4	35.47%	1,735.5	3,058.1	6.00%	183.5	1,919.0	(123.1)
2021	8,212.9	25.22%	2,071.2	4,715.9	36.46%	1,719.3	3,497.0	6.00%	209.8	1,929.1	(142.1)
2022	8,483.9	24.76%	2,100.9	4,532.2	37.55%	1,702.0	3,951.7	6.00%	237.1	1,939.1	(161.8)
2023	8,763.9	24.32%	2,131.5	4,344.6	38.77%	1,684.2	4,419.3	6.00%	265.2	1,949.4	(182.1)
2024	9,053.1	23.89%	2,163.0	4,151.7	40.13%	1,665.9	4,901.4	6.00%	294.1	1,960.0	(203.0)
2025	9,351.8	23.48%	2,195.5	3,953.3	41.66%	1,647.0	5,398.5	6.00%	323.9	1,970.9	(224.6)
2026	9,660.5	23.07%	2,229.1	3,753.5	43.37%	1,628.0	5,906.9	6.00%	354.4	1,982.4	(246.7)
2027	9,979.3	22.69%	2,263.9	3,554.6	45.27%	1,609.0	6,424.6	6.00%	385.5	1,994.5	(269.4)
2028	10,308.6	22.31%	2,299.7	3,351.5	47.43%	1,589.7	6,957.1	6.00%	417.4	2,007.1	(292.6)
2029	10,648.8	21.94%	2,336.7	3,148.9	49.87%	1,570.4	7,499.9	6.00%	450.0	2,020.4	(316.3)
2030	11,000.2	21.59%	2,375.0	2,945.5	52.66%	1,551.0	8,054.7	6.00%	483.3	2,034.3	(340.7)
2031	11,363.2	21.25%	2,414.5	2,741.8	55.86%	1,531.6	8,621.3	6.00%	517.3	2,048.9	(365.6)
2032	11,738.2	20.92%	2,455.3	2,536.2	59.62%	1,512.0	9,201.9	6.00%	552.1	2,064.1	(391.2)
2033	12,125.5	18.83%	2,283.7	2,333.4	54.81%	1,278.9	9,792.1	6.00%	587.5	1,866.4	(417.3)
2034	12,525.7	17.83%	2,233.3	2,132.3	54.67%	1,165.8	10,393.4	6.00%	623.6	1,789.4	(443.9)
2035	12,939.0	17.37%	2,247.8	1,942.3	57.52%	1,117.2	10,996.7	6.00%	659.8	1,777.0	(470.8)
2036	13,366.0	15.87%	2,121.2	1,760.7	52.64%	926.8	11,605.3	6.00%	696.3	1,623.1	(498.1)
2037	13,807.1	15.39%	2,125.1	1,587.2	54.58%	866.2	12,219.9	6.00%	733.2	1,599.4	(525.7)
2038	14,262.7	15.46%	2,205.1	1,420.4	62.00%	880.7	12,842.3	6.00%	770.5	1,651.2	(553.9)
2039	14,733.4	16.43%	2,420.5	1,260.8	81.67%	1,029.7	13,472.5	6.00%	808.4	1,838.1	(582.4)
2040	15,219.6	14.92%	2,270.8	1,105.8	73.45%	812.3	14,113.8	6.00%	846.8	1,659.1	(611.7)
2041	15,721.8	14.14%	2,223.0	954.8	72.83%	695.4	14,767.0	6.00%	886.0	1,581.4	(641.6)
2042	16,240.6	13.21%	2,144.7	809.0	9.53%	77.1	15,431.7	6.00%	925.9	1,003.0	(1,141.7)
Total:			$65,520.7			$43,150.0			$12,831.3	$55,981.3	$(9,539.4)

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

Creation of a New Public Pension Bureaucracy. The bill as amended would create an entirely new public employee retirement system bureaucracy, which, in time, would eventually replace both PSERS and SERS. As with the creation of any new, large governmental entity, the establishment of PERS will be an expensive and complex undertaking. If it is the intent of Commonwealth policy makers to replace the two existing, statewide, defined benefit pension systems with a single defined contribution system for public employees, it may be more efficient and cost effective to do so by adding one or more defined contribution benefit tiers to PSERS and SERS. Both PSERS and SERS already possess the physical infrastructure, systems, personnel and expertise to successfully administer such a retirement benefit plan.

Closure of PSERS and SERS. Under the bill as amended, PSERS and SERS would be closed to new members. Both retirement Systems will retain their current active and annuitant populations and funding for the retirement benefits of those members will continue for many decades. In actuarial terms, the funding dynamics of such "closed groups" differ significantly from an open group in which there is a continuous influx of new active members, and present funding challenges that will need to be addressed in the future through modification of the Systems' respective retirement statutes.

Benefit Value and Security. While a detailed benefit comparison was beyond the scope of the Commission's actuarial note, the DC plan proposed in the bill as amended would provide future employees with a retirement income that is likely to be less valuable, predictable and secure than PSERS' or SERS' traditional DB plans. During the past decade, defined contribution plan participants have endured two major market down-turns that have negatively affected the investment performance of their retirement accounts; the first during the period from roughly 2001-2003, and most recently in 2008. In view of these past market fluctuations, retirement planning based on projected DC account balances is likely to be less predictable and involve greater individual attention to risk management than participation in a traditional DB plan. The General Assembly and the Governor must determine the appropriateness of such a change in the Commonwealth's public pension policy.

Appropriate Delegation of Legislative Authority. The bill as amended empowers the PERS Board to develop the details of major plan design elements and administrative details by rule or regulation. The General Assembly and the Governor must determine if the broad powers afforded the PERS Board constitutes an appropriate delegation of legislative authority.

Special Membership Classes. Under the SERS Code, there are a number of special categories of public employees entitled to enhanced benefits, reduced superannuation requirements, or both. These include members of the General Assembly, the judiciary, Pennsylvania State Police Officers and certain other hazardous duty personnel. Under the bill as amended, there are no special benefit provisions for these groups of employees. The uniform benefit level under PERS would result in a major reduction in the value of employer-provided benefits for these groups of employees in the future and would result in significant benefit disparities between similarly situated employees.

Judicial Benefits. The Supreme Court of the Commonwealth has ruled that, in order to preserve an independent judiciary, judges must be adequately compensated, pension benefits are part of compensation, and all members of a single-level court performing similar functions and exercising similar authority must be compensated at the same rate. As drafted, the bill as amended ignores the special status of judicial benefits. Based upon the independent status of the judiciary in Pennsylvania and the case law regarding the special status of its members, if enacted, the bill as amended would almost certainly be challenged in the courts. The lack of a severability clause in the bill could result in it being entirely voided.

Treatment of Educational Employees. Under current law, “school employees” (employees of PASSHE institutions, most employees of the Pennsylvania State University, and community college employees) are eligible to choose coverage in an employer-approved, defined contribution “alternative retirement program” as an alternative option to membership in either PSERS or SERS. Under the bill as amended, it appears that new employees of these educational institutions would no longer have the option to select membership in an alternative retirement program such as TIAA-CREF. Beyond reducing employer costs associated with active member benefits, the rationale for mandating replacement of a well-established defined contribution plan (such as TIAA-CREF) with a new defined contribution providing a benefit of lesser value is unclear.

Adequacy of Disability and Death Benefits for Hazardous Duty Personnel. Historically, it has been the practice of the Commonwealth to provide special disability and death benefits to public safety employees due to the hazardous nature of such employment. The bill as amended represents a major departure from past practice by providing no such special benefits for hazardous duty personnel.

Disparate Treatment. The Commonwealth has elected to exclude members of the State Police from Social Security coverage. Therefore, those employees would receive lesser benefits than other PERS members.

Collective Bargaining and Arbitration. Both the PSERS and SERS Codes currently contain specific provisions prohibiting the use of collective bargaining agreements or arbitration awards between public employers and employees to award benefits. These provisions were included partly in reaction to cases in which enhanced benefits had in the past been awarded to certain groups of employees. The amended bill as written includes no specific provision prohibiting the use of collective bargaining agreements or arbitration awards to award additional employee pension benefits, which could lead to the use of such methods to award supplementary or enhanced benefits not provided under PERS.

Potential Liability Exposure. As drafted, the bill as amended contains numerous plan design deficiencies and ambiguities. If left unaddressed, these deficiencies may expose the PERS Board, the Commonwealth, and other public employers to litigation brought by employees over retirement benefit entitlement issues.

Tax Qualification. The bill as amended states that PERS shall be administered as a tax-qualified plan under the IRC. However, this declaration alone may prove insufficient to ensure the tax-qualified treatment of PERS. Based on the Commission's understanding of the IRC tax-qualification rules, employee contributions to a DC plan sponsored by a governmental entity can only be made on a pre-tax basis if plan membership is mandatory or there is a one-time irrevocable salary reduction agreement in place. The bill as amended should be reviewed by qualified legal counsel specializing in tax-qualification issues to ensure IRC compliance.

Retired Employee Health Program. The Retired Employee Health Program (REHP) provides for Commonwealth-subsidized post-retirement healthcare benefits to employees of most Commonwealth agencies. Eligibility for these benefits is tied to an employee's years of credited service in SERS and the employee's age at retirement. It is unclear how or if REHP participation would be incorporated into the PERS plan.

Pension Forfeiture Act. It is unlikely that the Public Employee Pension Forfeiture Act, 1978, July 8, P. L. 752, No 176, as amended, would apply to the new defined contribution plan, since the employee's share of the funds vests immediately with the employee at the time of contribution.

Inadequate Technical Provisions. In reviewing the bill as amended, the Commission staff noted numerous deficiencies in the areas of plan design, drafting ambiguities, drafting inconsistencies, the use of undefined terms, and the use of apparently contradictory language. The bill should be thoroughly reviewed and revised to correct these deficiencies prior to enactment. Following are the more significant issues noted by the staff.

Funding of Administrative Expenses. The bill as amended is unclear on how the administrative expenses of PERS are to be funded. Under Section 7105(f), the PERS Board will be required to submit an annual budget to the General Assembly for the administrative expenses of the System. The approved expenses are to be paid "in whole or in part" from member "nonvested forfeitures" (a term which is not defined) in PERS, and reference is also made to the payment of directed commissions by the board. Section 7108 states that, "all other expenses arising from the administration of the System," are to be paid from the individual retirement accounts of active members of the System. The creation of a large governmental institution such as PERS will be costly. Because PERS will initially have no assets and few members, it seems likely that the current funding process provided for in the bill as amended will prove insufficient, at least in the early years of operation. It appears likely that appropriations, either from the Commonwealth General Fund or some other source identified and authorized by the General Assembly, will be necessary to meet the initial and ongoing annual administrative funding requirements of PERS.

Disability Provisions. The disability retirement provisions contained in the bill as amended are unclear. The bill as amended indicates that the employer is to continue to make matching contributions in the event of disability at the same rate that was provided for before the disability occurred (Section 7112(b)). However, there is no provision in place to determine what qualifies as a disability and if that disability is permanent or temporary. In addition, the contributions are to continue until age 65. There is no provision to cease the contribution prior to age 65 if the member is no longer disabled. If contributions are to cease, a provision for monitoring the status of disabled members through a periodic medical review would need to be added. The bill as amended provides no guidance as to the ongoing contributions if a disabled member withdraws part or all of the account balance. Since the employer contribution is a match of the member contribution, up to 6% of payroll, the potential exists for the disability benefit to be zero.

Inconsistent Effective Dates. The definition of public employee in Section 7102 of the bill as amended refers to employees that begin public service after November 30, 2011. However, other sections make repeated references to an effective date of after July 1, 2011.

Vesting and Treatment of Non-Vested Members. The vesting provisions require clarification. Members of PERS would become fully-vested in the employer contribution portion of the plan after three years of service. Presumably, employees who terminate service prior to vesting would be entitled to a return of their own contributions to the plan, however, there is no specific provision for this contingency, beyond a reference to the return of "accumulated deductions" (a term which is not defined) in Section 7115(f). The bill as amended should clearly indicate that the account balance derived from employee contributions adjusted for earnings and expenses is always 100% vested. Also, the bill as amended provides that a part-time member "shall only be vested if the member is compensated for at least 1,000 hours per year" (Section 7113(a)). This provision should be clarified to indicate that three years of at least 1,000 hours per year is required to be vested in the account balance due to employer contributions. Section 7113(b)(2) requires the forfeiture of the employer contribution portion of a non-vested member's account upon the death, "or other termination of public service of the active member," and would permit the balance of any such account to be used to defray the administrative expenses of PERS under Section 7105(f).

Status of Members Returning to Service. The treatment of former active members of SERS and PSERS (vestees, inactive members and annuitants) who return to employment following a break in service is not clear. Section 7115(d) seems to indicate that membership in PERS would be mandatory only for those employees who enter into public service, "for the first time after July 1, 2011." Likewise, Section 7117(1) indicates that PERS membership would not be mandatory for any employee who is employed prior to July 1, 2011. However, Section 7117(2) of the bill as amended contains the contradictory and confusing requirement that PERS membership, "shall apply to any person who is a public school employee or state employee before July 1, 2011, and who is not a public employee on July 1, 2011, *but reenters public service after July 1, 2011."*

Superannuation Age. Section 7115(f) refers to superannuation age. However, superannuation age is not defined in the bill as amended, and superannuation age is generally not relevant for members in a DC plan.

Optional or Mandatory Nature of Membership. The nature of membership in PERS requires clarification. As written, membership in PERS is mandatory, yet contributions appear to be voluntary. Mandatory participation in a defined contribution pension plan normally involves a minimum contribution requirement. The bill as amended does not set a minimum participant contribution rate for either the member or the employer, which could mean that members may choose to contribute nothing, and likewise, the employer would also make no contributions toward the member's retirement plan. The purpose of mandating participation in a defined contribution pension plan when no minimum contribution to the plan is required is not apparent. Further, there may be serious tax-qualification issues involved with such an approach. Based on the Commission's understanding of the IRC tax-qualification rules, employee contributions to a defined contribution plan sponsored by a governmental entity can only be made on a pre-tax basis if plan membership is mandatory or there is a one-time irrevocable salary reduction agreement in place. Finally, the apparently optional nature of plan participation is contradicted in Section 7106(d) which mandates a default investment option provision applicable to members who do not elect one and requiring that "the active member contribution in the default investment option shall be 6% of the active member's pensionable earnings." It is also unclear how often or if a member may change the rate of contribution to the plan.

Service Credit. Section 7114(b) refers to credited service. However, credited service is not defined in the bill as amended and is generally not relevant for members in a DC plan.

Municipal Employees. Section 7117(1) refers to municipal employees. Since municipal employees are not covered by PERS this reference should be deleted prior to enactment.

*Board Members*hip. The bill as amended does not include municipal employees in PERS, but the chairman of the Pennsylvania Municipal Retirement System (PMRS) is a member of the PERS Board (Section 7104(b)).

COMMISSION RECOMMENDATION

On September 9, 2010, 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

Senate Bill Number 566, Printer's Number 577, was introduced and referred to the Senate Finance Committee on March 4, 2009.

Bill ID: Senate Bill Number 1185, Printer's Number 1672

System: Public School Employees' Retirement System

Subject: Hybrid Benefit Plan

SYNOPSIS

Senate Bill Number 1185, Printer's Number 1672, would amend the Public School Employees' Retirement Code (Code) to: 1) establish a hybrid retirement benefit tier that would combine elements of both a defined benefit (DB) plan and a defined contribution (DC) plan and would be applicable to all members of the Public School Employees' Retirement System (PSERS) who become members of PSERS after June 30, 2010; 2) amend Section 8535 of the Code to alter the current cost-sharing arrangement between the Commonwealth and PSERS employers, by effectively capping future annual increases in the employer contribution rate payable by school entities to an amount not to exceed the "index" as that term is defined in the act of June 27, 2006 (P. L. 1873, No. 1), known as the Taxpayer Relief Act (Special Session Act 1 of 2006), and mandating that in any year in which an increase in the employer contribution rate exceeds the Act 1 index, the Commonwealth would pay any additional required contributions that exceed the index; and 3) amend Section 8328 of the Code to permit a modification of the mandated minimum employer contribution floor rate (currently four percent plus the premium assistance rate) in the event the funded ratio of the PSERS fund (ratio of assets to liabilities) reaches 100% or greater.

DISCUSSION

The Public School Employees' Retirement Code (Code) is a governmental, cost-sharing, multiple-employer pension plan. The designated purpose of the Public School Employees' Retirement System (PSERS) is to provide retirement allowances and other benefits, including disability and death benefits, to public school employees. Membership in PSERS is mandatory for most school employees. Certain other employees are not required but are given the option to participate. As of June 30, 2009, there were 279,701 active members of PSERS and 177,963 annuitants and beneficiaries receiving benefits from the System.

For most active members of PSERS, the basic benefit formula used to determine the annual retirement benefit is equivalent to the product of 2.5% multiplied by the member's total years of accumulated service credit, multiplied by the member's final average (highest three years) compensation. Since the passage of Act 9 of 2001 (which increased the accrual rate for most members from 2.0% to 2.5%), most members of PSERS are Class T-D members and contribute 7.5% of pay to the System.

Superannuation or normal retirement age is that date on which a member may terminate service with the public employer and receive a full retirement benefit without reduction. Under the Code, superannuation 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.

Defined Benefit (DB) and Defined Contribution (DC) Retirement Systems

There are two predominate approaches to pension plan design employed in the public and private sectors to provide employee retirement benefits. As evidenced by the nomenclature, the approaches fundamentally differ in regard to the aspect of the pension plan that is "defined," or fixed, in the plan's governing document.

In a "defined benefit" (DB) plan (which remains the dominant plan type in the public sector), the pension benefit to be provided at retirement is defined, while the contributions to be made over the period of employment are variable based on the experience of the pension fund. Upon retirement, a DB plan participant is entitled to receive a definitely determinable benefit, often for life, that is calculated using a formulation that considers factors such as age, service with the employer and compensation. Because the benefit is defined and calculated using a formula and is not dependent on an individual's account balance, members of DB plans are largely insulated from both negative and positive fluctuations of the investment markets.

By contrast, in a "defined contribution" (DC) pension plan (the dominant plan type in the private sector), the contributions to be made over the period of employment are defined, while the pension benefit to be provided at retirement is variable based on the experience of the pension fund. Upon retirement or separation from the employer, a DC plan participant is generally entitled only to the balance standing to the credit of the individual's retirement account. Market performance directly impacts the value of an individual's retirement account.

The distinction between the DB and DC approaches is most significant in the placement of the risk associated with investment earnings over the period of employment. The fixed benefit in a DB pension plan means that the investment experience impacts the contribution requirements, increasing them when investment earnings are lower than anticipated and decreasing them when earnings are greater than anticipated. The fixed contributions in a DC pension plan mean that the investment experience impacts on the benefit amount, increasing it when earnings are higher and reducing it when earnings are lower. Therefore, the employer, as contributor, bears the investment risk in a DB plan, and the employee bears the investment risk in a DC pension plan.

For most employees, defined contribution plans are generally regarded as more valuable for those in the early stages of their careers or for those who are employed in careers that require greater mobility. Defined contribution accounts are portable and can readily move with the employee as that employee moves from one employer to the next. In contrast, defined benefit plans are relatively more valuable for those employees who tend to remain with one employer and to long-service employees in the later stages of their careers, because the value and cost of the defined benefits earned each year increase significantly as employees approach retirement age.

Hybrid Benefit Plan

The bill would establish a new retirement benefit plan applicable to all members of PSERS who become members of the System after June 30, 2010. The new benefit tier established by the bill would be a hybrid benefit plan, combining elements of both a defined benefit (DB) plan and a defined contribution (DC) plan.

Under the bill, any employee who becomes a member of PSERS after June 30, 2010, would become a member of a new membership class, known as Class T-E and would be a mandatory member of the hybrid benefit plan. A Class T-E member would be entitled to a defined benefit equal to a 1% annual benefit accrual rate and would be required to make employee contributions equal to 3.25% of compensation. Most current members of PSERS are entitled to a defined benefit equal to a 2.5% annual accrual rate and make employee contributions equal to 7.5% of pay. Members would become vested in the DB component of the hybrid plan after accumulating 10 years of credited service. Current members of PSERS are vested after accumulating 5 years of credited service.

In addition to the defined benefit portion of the hybrid plan, the bill would amend the Code by adding Chapter 86, effectively integrating into the Code a defined contribution benefit plan, known as the "Defined Contribution Retirement Benefit Program." Membership in the program would be mandatory for all Class T-E members, with contributions made by the employer (equal to 2% of the member's compensation) and by the member (a minimum of 3% of compensation) credited to an account for each member. A member has the option of making additional contributions to the member's individual account, to the extent permitted by Federal law. Whereas the DB component of the hybrid plan does not entitle new members to vesting of retirement benefits until 10 years of service, the defined contribution plan provides 100% vesting from the first day of membership.

The bill would not affect the retirement benefits of current active members of the System. Instead, the bill seeks to create a reduced benefit tier within PSERS applicable only to employees who become members of PSERS after June 30, 2010. Under the bill, current members of PSERS are exempted from the provisions of the new mandatory benefit tier, unless or until there is a break in service.

In Pennsylvania, public employee retirement benefits are recognized as deferred compensation for work already performed, which confers upon public employees certain contractual rights protected by the Pennsylvania Constitution (Article I Section 17). *Police Officers of Hatboro v. Borough of Hatboro,* 559 A.2d 113 (Pa. Cmwlth 1989); *McKenna v. State Employees' Retirement Board,* 495 Pa. 324, 433 A.2d 871 (1981); *Catania v. State Employees' Retirement Board,* 498 Pa. 684, 450 A.2d (1982). These contractual pension rights become fixed upon the employee's entry into the retirement system and cannot be subsequently unilaterally diminished or adversely affected, regardless of whether (1) the member is vested; or (2) the devaluation is necessary for actuarial soundness. *Association of Pa. State College and University Faculties v. State System of Higher Education,* 505 Pa. 369, 479 A.2d 962 (1984). See also *Hughes v. Public School Employees' Retirement Board*, 662 A.2d 701 (Pa. Cmwlth. 1995), *alloc. denied,* 542 Pa. 678, 668 A.2d 1139 (1995) (member has property interest in pension benefit).

By creating a new benefit tier applicable only to employees who become members of PSERS after June 30, 2010, the bill avoids impairing the contractual retirement benefit rights of current members of the System, while having the effect of creating a new contractual relationship between the public employer and new members of the System.

Change in Cost-Sharing Between PSERS Employers and the Commonwealth

Each year, the PSERS board, in consultation with the System's consulting actuary, establishes the annual employer contribution requirements for the retirement system. There are four basic components that comprise the total employer contribution requirement: 1) the employer normal cost rate (the normal cost represents the value of benefits earned in a given year); 2) the accrued liability contribution rate (the accrued liability represents the portion of the present value of future plan benefits attributable to service accrued as of a given date); 3) the supplemental annuity contribution rate (the amortization contribution requirement applicable to past supplemental annuities); and 4) the premium assistance contribution rate (the amount required to fund the premium assistance program in a given year).

Under current law, PSERS employers and the Commonwealth share the cost of required employer contributions to the System. The current process requires "school entities" as defined in the PSERS Code (school districts, intermediate units, and area vocational technical schools) to initially pay the entire amount of the required employer contributions. The Commonwealth then reimburses school entities with an amount that is not less than 50% of the aggregate employer contribution rate. (The actual amount is determined through a formula known as the "Market Value Income Aid Ratio" as defined in Section 2501 (14.1) of the Public School Code of 1949, which is also used in calculating other reimbursements by the Commonwealth and between school districts.) The current statewide average is roughly a 55%/45% ratio, with the Commonwealth paying 55%. All other PSERS employers that are not school entities currently pay one-half of the employer contribution rate, with the Commonwealth contributing the remaining one-half. Examples of PSERS employers that are not school entities as defined in the PSERS Code include the colleges and universities under the State System of Higher Education, community colleges, various schools for the blind and deaf, charter schools and miscellaneous other employers.

The bill would amend Section 8535 of the PSERS Code to alter the current cost-sharing arrangement between the Commonwealth and PSERS employers. The bill would effectively cap future annual increases in the share of the employer contribution rate payable by school entities to an amount not to exceed the "index" as that term is defined in the act of June 27, 2006 (P. L. 1873, No. 1), known as the Taxpayer Relief Act (Special Session Act 1 of 2006). In any year in which an increase in the employer contribution rate exceeds the index, the Commonwealth would reimburse school entities for any additional required contributions that exceed the index.

Under the new cost-sharing arrangement proposed by the bill, the Commonwealth would experience large increases in employer contributions beginning in fiscal year 2012-2013 when the unfunded liability portion of the employer contribution rate begins to increase significantly. This employer contribution "rate spike" is the result of large unfunded liabilities generated by four major factors: 1) the two major market down-turns during the past decade, from roughly 2001-2003 and again in 2008; 2) the benefit enhancement provided to active members of PSERS by the passage of Act 9 of 2001; 3) the additional unfunded liability resulting from the two-tier cost-of-living adjustment provided to retired PSERS members by Act 38 of 2002; and 4) changes to funding methods resulting from the enactment of Act 38 of 2002 and Act 40 of 2003. Combined, Acts 38 and 40 had the effect of deferring the funding of liability. Of the two, Act 40 had the greatest impact by requiring PSERS to amortize certain gains and losses over different periods of time. Under Act 40, the recognition of pre-Act 9 gains was accelerated by amortizing these gains over a 10-year period, while the recognition of post-Act 9 losses was delayed by amortizing these losses over 30 years. The result was, in effect, a mismatch of the amortization of gains and losses, generating a 10-year credit that has had the consequence of suppressing the employer contribution rate and masking the true costs of the System. This 10-year credit will be fully amortized by fiscal year 2012-2013, which corresponds with the projected contribution spike.

The bill would have the effect of shifting a significant proportion of the costs of providing required employer contributions from the school employers to the Commonwealth. The bill would retain the current cost sharing relationship between the Commonwealth and the less than one percent of participating PSERS employers that are not defined as school entities under the Code. These employers would not benefit from the contribution limits afforded to school entities under the bill and would be required to continue to pay one-half of any future employer contribution requirements as certified by the PSERS Board. Since the Philadelphia School District, intermediate units and area vocational-technical schools are not subject to Act 1 and its index, it is uncertain whether those entities would be entitled to benefit from the contribution limits granted to other school employers.

Taxpayer Relief Act (Special Session Act 1 of 2006) Act 1 Index

The bill would use the Act 1 index to establish what would effectively function as an employer contribution cap applicable to participating PSERS employers that are "school entities" as defined in the PSERS Code. The intended purpose of the Act 1 index is to aid school entities in formulating annual budgets and to serve as a ceiling on local property tax increases. Act 1 is mandatory for all school districts (excluding the School District of Philadelphia) and requires a voter referendum for any proposed tax increase that exceeds the Act 1 index. School districts may only exceed the index with voter approval or by receiving exceptions from the Commonwealth for uncontrolled cost increases, such as those for: 1) emergencies and disasters; 2) court orders; 3) special education services; and 4) other state or federally mandated programs.

Act 1 defines the index as the average of the percentage increase in the statewide average weekly wage and the Employment Cost Index. The statewide average weekly wage (SAWW) is determined by the Pennsylvania Department of Labor & Industry in the same manner as the average weekly wage under the Unemployment Compensation Law, except that the SAWW is calculated for the preceding calendar year. The calculation is based on the statewide average of salaries paid to those who work in Pennsylvania. The Employment Cost Index (ECI) is reported by the Bureau of Labor Statistics of the U. S. Department of Labor, and is the most recent official figure for the previous 12-month period beginning July 1 and ending June 30. The ECI Series for Elementary and Secondary Schools are quarterly measures of changes in labor costs for specific types of employers.

Under Act 1, the Pennsylvania Department of Education calculates the index, or "base index," for use as the ceiling for tax increases in each school year. School districts that have a market value of real estate to personal income aid ratio greater than 0.400 for the school year prior to the school year for which the index is calculated are allowed to use an "adjusted index." The Commonwealth uses the market value/income aid ratio as the method for determining a school district's overall level of wealth. Market value consists of the valuation placed upon a school district's taxable real property by the State Tax Equalization Board, while personal income is the valuation of the total taxable income in a school district for the preceding tax year. The adjusted index is calculated by multiplying the base index by the sum of:

1) 0.75; and
2) the school district's market value/income aid ratio for the school year prior to the school year for which the index is calculated.

According to data supplied to the Commission by the Department of Education, of the 501 school districts in Pennsylvania, 94 were certified at the base index of 2.9% for the 2010-2011 fiscal year. The remaining school districts were permitted to exceed the base, with the highest adjusted index for a school district in 2010-2011 calculated at 4.7%. The higher the index, the higher a school district can increase taxes without the need for voter approval. The Pennsylvania Department of Education does not provide projections of the base index rate for future school years. The following table shows the base index for each school year since the implementation of the Act 1 index in 2006.

For School Year:	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
Statewide Average Weekly Wage	$735.29	$756.18	$788.47	$824.79	$846.71
Employment Cost Index	96.6	100.5	105.0	108.8	112.1
% Increase - SAWW	4.2%	2.8%	4.3%	4.6%	2.7%
% Increase - ECI	3.5%	4.0%	4.5%	3.6%	3.0%
Base Index	**3.9%**	**3.4%**	**4.4%**	**4.1%**	**2.9%**

Minimum Employer Contribution Rates

Act 38 of 2002 first established a 1% minimum employer contribution floor rate for both PSERS and SERS. In 2003, the mandated rate was increased through the enactment of Act 40 of 2003 for both Systems. For PSERS, the minimum employer contribution rate was increased effective July 1, 2004, from 1% to 4% plus the premium assistance contribution rate. The intent of the employer contribution floor was to provide for a statutory minimum funding level and to hedge against future unfavorable plan experience.

The bill would amend Section 8328 of the Code to provide that in any year in which the funded ratio of the System is 100% or greater, the total contribution rate shall not be less than 4% plus the premium assistance contribution rate, minus a percentage amount equal to the ratio of the employer contributions into the DC plan for all active Class T-E members to the total payroll for school employers for the previous fiscal year.

As of June 30, 2009, the employer normal cost rate for PSERS was 8.08% (plus .64% for health insurance). The employer normal cost rate represents the employer portion of the value or cost of the benefits earned during a given year, based upon the System's actuarial assumptions and methods. Ideally, actual employer contributions to the System should be equal to or at least close to the employer normal cost rate. The effect of this amendment to Section 8328 would be to permit future employer contributions to the System to continue to fall well below employer normal cost and below the current minimum employer contribution floor rate of 4% if the funded ratio of the fund is 100% or greater.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill and an actuarial cost estimate prepared by the consulting actuary for the Public School Employees' Retirement System (PSERS), and has determined the effects of the bill on PSERS. The Commission's consulting actuary has determined that the bill would have no effect on PSERS' unfunded actuarial accrued liability, because the hybrid plan provided for by the bill would affect new members of PSERS only. The Commission's consulting actuary has determined that, over time, the bill would decrease employer contribution rates as an increasing number of Class T-E members enter the System, because the cost of providing benefits under the hybrid plan is less than for current members. The defined benefit portion of the employer normal cost rate as a percentage of appropriation payroll would decline as current members earning a 2.5% annual accrual rate exit the System and are replaced by new members in Class T-E earning a 1% annual accrual rate. However, this reduction in the defined benefit employer normal cost rate is partially offset by the addition of the defined contribution rate for new members in Class T-E, resulting in a small increase in employer contribution requirements from fiscal year 2011 through 2013. The 2% defined contribution employer rate for Class T-E member compensation represents only a small percentage of appropriation payroll beginning in fiscal year 2011, but steadily increases and is almost completely phased-in by fiscal year 2039 as Class T-E members are projected to represent the majority of the active PSERS membership. Although there would be some employer cost savings resulting from implementation of the reduced benefit tier under the bill, the savings are relatively small, amounting to 1.75% of payroll in 2038. The estimated change in employer cost for fiscal years 2011 through 2039 is summarized in the following table.

Table I

Hybrid Plan
Projection of Employer Contribution Rates

FY ending June 30	Current Plan	Total Employer Contribution Rates Senate Bill Number 1185			Change
		DB Component	DC Component	Total	
2011	8.22%	8.22%	0.10%	8.32%	0.10%
2012	10.59%	10.59%	0.19%	10.78%	0.19%
2013	29.22%	28.97%	0.28%	29.25%	0.03%
2014	32.09%	31.63%	0.36%	31.99%	-0.10%
2015	33.60%	32.95%	0.44%	33.39%	-0.21%
2016	33.27%	32.43%	0.51%	32.94%	-0.33%
2017	32.74%	31.72%	0.58%	32.30%	-0.44%
2018	32.06%	30.83%	0.64%	31.47%	-0.59%
2019	31.27%	29.83%	0.70%	30.53%	-0.74%
2020	30.42%	28.78%	0.76%	29.54%	-0.88%
2021	29.56%	27.77%	0.82%	28.59%	-0.97%
2022	28.75%	26.82%	0.88%	27.70%	-1.05%
2023	27.95%	25.91%	0.94%	26.85%	-1.10%
2024	27.18%	25.05%	1.00%	26.05%	-1.13%
2025	26.44%	24.23%	1.06%	25.29%	-1.15%
2026	25.74%	23.44%	1.13%	24.57%	-1.17%
2027	25.05%	22.68%	1.19%	23.87%	-1.18%
2028	24.40%	21.96%	1.25%	23.21%	-1.19%
2029	23.78%	21.25%	1.32%	22.57%	-1.21%
2030	23.19%	20.59%	1.39%	21.98%	-1.21%
2031	22.63%	19.93%	1.45%	21.38%	-1.25%
2032	22.10%	19.30%	1.52%	20.82%	-1.28%
2033	19.46%	16.50%	1.59%	18.09%	-1.37%
2034	18.16%	15.07%	1.66%	16.73%	-1.43%
2035	16.82%	13.59%	1.72%	15.31%	-1.51%
2036	15.65%	12.28%	1.79%	14.07%	-1.58%
2037	14.33%	10.79%	1.85%	12.64%	-1.69%
2038	13.88%	10.21%	1.92%	12.13%	-1.75%
2039	14.64%	10.92%	1.97%	12.89%	-1.75%

The Commission's consulting actuary also estimated the projected changes in the future employer-Commonwealth cost-sharing ratio resulting from the bill and determined that the bill would have the effect of shifting a significant proportion of the costs of providing required employer contributions from participating PSERS employers to the Commonwealth. Under the bill, the Commonwealth would experience large increases in employer contributions beginning in fiscal year 2012-2013 when the unfunded liability portion of the employer contribution rate begins to increase significantly. The higher employer contributions paid by the Commonwealth would continue for the next 20 years through fiscal year 2032, when the employer contribution rate is reduced due to the lower normal costs associated with increased membership in Class T-E and the total employer contribution rate for the defined benefit portion is no longer limited by the Act 1 index. Beginning in fiscal year 2033, the Commonwealth's contributions would be reduced compared to current law due to increased membership in Class T-E and school employers bearing the full cost of the 2% defined contribution employer rate for PSERS members. The results of the analysis are summarized in the following table.

Table II

Estimated Change in Employer Cost-Sharing
($ amounts in millions)

	Current Code			If Senate Bill 1185 were enacted			Increase / (Decrease)	
Fiscal Year ending June 30	Total Employer Contribution Rate	Common-wealth Portion	PSERS Employer Portion	Total Employer Contribution Rate	Common-wealth Portion	PSERS Employer Portion	Common-wealth Contribution	PSERS Employer Contribution
2011	8.22%	55%	45%	8.32%	71%	29%	$191	($178)
2012	10.59%	55%	45%	10.78%	76%	24%	$329	($302)
2013	29.22%	55%	45%	29.25%	90%	10%	$1,477	($1,473)
2014	32.09%	55%	45%	31.99%	90%	10%	$1,661	($1,676)
2015	33.60%	55%	45%	33.39%	90%	10%	$1,769	($1,801)
2016	33.27%	55%	45%	32.94%	89%	11%	$1,754	($1,806)
2017	32.74%	55%	45%	32.30%	88%	12%	$1,722	($1,794)
2018	32.06%	55%	45%	31.47%	87%	13%	$1,678	($1,771)
2019	31.27%	55%	45%	30.53%	86%	14%	$1,625	($1,734)
2020	30.42%	55%	45%	29.54%	85%	15%	$1,559	($1,686)
2021	29.56%	55%	45%	28.59%	84%	16%	$1,488	($1,632)
2022	28.75%	55%	45%	27.70%	82%	18%	$1,412	($1,578)
2023	27.95%	55%	45%	26.85%	81%	19%	$1,326	($1,514)
2024	27.18%	55%	45%	26.05%	79%	21%	$1,232	($1,447)
2025	26.44%	55%	45%	25.29%	77%	23%	$1,128	($1,374)
2026	25.74%	55%	45%	24.57%	76%	24%	$1,013	($1,291)
2027	25.05%	55%	45%	23.87%	74%	26%	$891	($1,202)
2028	24.40%	55%	45%	23.21%	71%	29%	$758	($1,104)
2029	23.78%	55%	45%	22.57%	69%	31%	$609	($995)
2030	23.19%	55%	45%	21.98%	67%	33%	$455	($875)
2031	22.63%	55%	45%	21.38%	64%	36%	$281	($747)
2032	22.10%	55%	45%	20.82%	61%	39%	$94	($607)
2033	19.46%	55%	45%	18.09%	53%	47%	($393)	($168)
2034	18.16%	55%	45%	16.73%	49%	51%	($611)	$2
2035	16.82%	55%	45%	15.31%	49%	51%	($659)	($1)
2036	15.65%	55%	45%	14.07%	48%	52%	($709)	($1)
2037	14.33%	55%	45%	12.64%	47%	53%	($765)	($6)
2038	13.88%	55%	45%	12.13%	46%	54%	($822)	($7)
2039	14.64%	55%	45%	12.89%	47%	53%	($849)	($40)
2011-2039		55%	45%		72%	28%	$19,644	($28,808)

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

Benefit Reduction. The bill would have the effect of reducing the annual benefit accrual rate from the current 2.5% of payroll for most members of PSERS to 1.0% for PSERS members who become members of the System after June 30, 2010. While the reduction in the accrual rate in the DB component of the hybrid plan is partially offset by the provision of a mandatory DC benefit component, the overall effect of the bill would be to mandate a benefit reduction applicable to new members of the System.

Benefit Value and Security. While a detailed benefit comparison was beyond the scope of the Commission's actuarial note, the hybrid retirement benefit plan proposed in the bill would provide employees with a retirement income that, in the aggregate, is likely to be less valuable, predictable and secure than PSERS' traditional DB plan. During the past decade, defined contribution plan participants have endured two major market down-turns that have negatively affected the investment performance of their retirement accounts; the first during the period from roughly 2001-2003, and most recently in 2008. In view of these past market fluctuations, retirement planning based on projected DC account balances is likely to be less predictable and involve greater individual attention to risk management than participation in a traditional DB plan. Future retirees who find that their DC account balances are proving insufficient to provide for their retirement needs may petition state government for relief.

Appropriateness of Change in Employer Cost-Sharing. Under current Code provisions, PSERS employers and the Commonwealth share roughly equally in the costs of providing required employer contributions. The bill would shift a major portion of these costs from employers to the Commonwealth. The General Assembly and the Governor will need to determine the appropriateness of such a reallocation of employer contribution requirements.

Conditional Reduction of Contribution Floor. The bill would amend Section 8328 of the Code to permit future employer contributions to PSERS to fall below the current minimum employer contribution floor rate of 4% if the funded ratio of the fund is 100% or greater. Such a conditional reduction in the contribution floor is unwarranted. Ideally, requiring contributions that more closely approximate employer normal cost would ensure a more fully-adequate level of future funding of member benefits.

Liability Exposure and Fiduciary Issues. In response to House Resolution No. 266 (2001-02 legislative session), the Public Employee Retirement Commission released a report entitled *Selected Issues Related to Governmental Defined Benefit & Defined Contribution Pension Plans* in December 2002. In preparing this report, the Commission requested assistance from the legal staffs of PSERS and SERS in preparing responses to certain study directives contained in Resolution No. 266, specifically directing the Commission to examine liability, contract impairment and fiduciary considerations with respect to the establishment of defined contribution programs within PSERS and SERS. The full discussion is contained in a memorandum dated July 3, 2002, from the Governor's Office of General Counsel. A copy of the unaltered memorandum is attached to this actuarial note transmittal.

Technical Considerations. In reviewing the bill, the Commission identified the following technical considerations.

Act 1 Index Calculation. For the purposes of the Commission's actuarial note, it was assumed that a school entity's employer contribution rate for a given fiscal year would be the lesser of the actual employer contribution rate for the fiscal year or the school entity's effective employer contribution rate for the prior year adjusted by the school entity's Act 1 Index. Additionally, the bill does not specify whether the "base" index or the "adjusted" index is to be utilized. Therefore, the language in the bill, as currently drafted, is somewhat ambiguous and may be subject to alternative interpretations. The bill sponsor may wish to amend the bill to set forth more precisely the exact method to be used in calculating and applying the Act 1 Index-based employer contribution limits.

Application of Act 1 Index Calculation for Certain Employers. The bill would limit employer contribution requirements to PSERS using the annual Act 1 index as applied to school entities. The term "school entities" is a defined term in the PSERS Code and includes school districts (including charter schools), intermediate units, and area vocational technical schools. One purpose of the Act 1 index is to impose an upper limit on the taxing authority of school districts, and the calculation and application of the index to school districts seems clear. It is less clear how the index would be calculated and applied to other "school entities" that do not possess independent taxing authority, and for which the Department of Education does not calculate an index. Additionally, the City of Philadelphia School District is specifically exempted from the provisions of Act 1, but is also defined as a "school entity" under the Code. The bill sponsor may wish to address these apparent operational inconsistencies.

Pension Forfeiture Act. It is unlikely that the Public Employee Pension Forfeiture Act, 1978, July 8, P. L. 752, No 176, as amended, would apply to the defined contribution portion of the hybrid plan, since ownership of the funds vests immediately in the employee at the time of contribution.

COMMISSION RECOMMENDATION

On May 27, 2010, 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.

ATTACHMENT

The memorandum dated July 3, 2002, from the Governor's Office of General Counsel referenced on page 29 follows on pages 31 through 41.

FINAL LEGISLATIVE STATUS

Senate Bill Number 1185, Printer's Number 1672, was introduced and referred to the Senate Finance Committee on February 3, 2010.

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM
STATE EMPLOYEES' RETIREMENT SYSTEM
Office of Chief Counsel
Governor's Office of General Counsel

DATE: July 3, 2002

SUBJECT: House Resolution 266 – Analysis of Legal Issues Relating to Defined Contribution Plans

TO:	Dale H. Everhart Executive Director Public School Employees' Retirement System		John Brosius Executive Director State Employees' Retirement System
FROM:	Charles K. Serine Deputy Chief Counsel Public School Employees' Retirement System	Through	Thomas E. Ross Chief Counsel Public School Employees' Retirement System
	Nicholas Joseph Marcucci Deputy Chief Counsel State Employees' Retirement System	Through	Harold H. Dunbar Chief Counsel State Employees' Retirement System

Introduction and Background

You have asked the Public School Employees' Retirement System ("PSERS") and the State Employees' Retirement System ("SERS") to jointly respond to certain legal issues raised in paragraphs four and five of House Resolution 266.

Specifically, the General Assembly, in paragraph four, seeks an analysis of the exposure to liability on the part of the Commonwealth and school employers arising out of legislation providing employees a choice between and/or a right to convert to either a Defined Benefit ("DB") plan or Defined Contribution ("DC") plan, including any liability for poor investment performance in a DC plan and possible contract impairment issues.

The General Assembly, in paragraph five, seeks an analysis of any changes in the fiduciary responsibilities and duties of the Commonwealth and school employers that may result from instituting a DC plan.

Although both paragraphs mention only the Commonwealth and school employers, nevertheless we believe that non-Commonwealth employers (*e.g.*, various independent authorities) will be implicated, as well as PSERS and SERS. The Retirement Systems will no doubt be required to select, and monitor the performance of, the DC plan providers. The Commonwealth and/or school employers may be secondarily liable, because ultimately, they would bear the brunt of any financial loss incurred by the Systems. In addition, there is a potential for the Systems' fund assets to be adversely impacted by the creation of a DC plan, which in turn may cause changes in the investment decisions of the Systems.

The extent of the liability exposure may depend on whether employees are given a choice to join a DC plan, and on whether the choice is offered to existing employees (either with or without an option to convert from the prior DB plan to the DC plan) or to new employees only on a prospective basis. The extent of the exposure may also depend on whether the DC plan is offered as an exclusive plan or as a supplement to the DB plan.[1]

Finally, there may also be some tax-related issues for current members who elect to transfer into a DC plan, and tax qualification issues for the fund itself as a result of such changes, but we do not view these issues as within the scope of the request.[2] Accordingly, we have not addressed these issues in this response.

Impact on Liability

The analysis regarding potential exposure of liability to the Systems and the employers must begin with an understanding of the fundamental difference between a DC plan and a DB plan.

Comparison of DB and DC Plans

Under a DB plan, such as exists at SERS and PSERS, the plan consists of a general pool of assets rather than individual dedicated accounts. The employee, upon retirement, is entitled to receive a fixed periodic payment, calculated on a pre-determined formula consisting of a percentage of final average salary times years of service. The employer bears the entire investment risk, and must cover any underfunding as a result of any shortfall that may result from the plan's investments. *See* 24 Pa.C.S. §8531 and 71 Pa.C.S. §5951 (the payment of annuities and other benefits are made an obligation of the Commonwealth).

Under a DC plan, however, the employer's contribution is fixed, and the employee receives whatever level of benefits the amount contributed will provide. An individual account for each employee is created, and benefits are based solely on the amount contributed to the employee's account. The employer's funding obligation is completed as soon as the employer makes the

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[1] For certain employee groups in the SERS System, any change may be problematic. For example, there are limits on the prospective amendment of judges' pensions. *See Goodheart v. Casey,* 565 A.2d 757 (Pa. 1989). State police pensions have also been given special treatment under collective bargaining agreements that may make changes difficult to implement. *See Commonwealth v. Conference of State Police Lodges,* 525 Pa. 40, 575 A.2d 94 (1990).

[2] For example, there may be tax-related issues concerning the treatment of employee contributions and the treatment of deemed employer contributions on a conversion to a DC plan.

required contribution to the employee's account, and subsequent events have no impact on this obligation. Thus, the employee bears the entire investment risk. *See, e.g., Nachman Corp. v. PBGC,* 446 U.S. 359 (1980).

There are certainly advantages and disadvantages to each type of plan. *See, e.g.* Jonathan Barry Forman, "Public Pension: Choosing between Defined Benefit and Defined Contribution Plans," 1999 L. Rev. M.S.U.-D.C.L. 187 (Spring 1999).[3] Even in the absence of a downturn in the market, however, an individual will usually fare worse, over time, under a DC plan than a DB plan, for two significant reasons. First, individuals tend to invest too conservatively, particularly as they approach the end of their working careers. *See* Gerald W. McEntee, "Others' Views: The Public Interest and Switch to DC Plans," Pension and Investment, June 23, 1997, at 12. Second, individuals are less likely to adequately diversify their portfolio, and less likely to recognize when to transfer funds from one type of investment to another. *See* Regina T. Jefferson, "Rethinking the Risk of Defined Contribution Plans," 4 Fla. Tax Rev. 607 (2000). *See also* John R. Neville, "Retire at Your Own Risk: ERISA's Return on Investment?," 68 St. John's L. Rev. 527, 545-46 (1994) (noting that "the majority of self-directed pension plan investors transferred funds to the stock market after it reached its high in 1987, and bailed out after the market crashed soon thereafter").

<u>Liability for Poor Performance</u>

This transfer of the risk of poor performance of investments from the employer to the individual, with the inevitable result of some individuals faring far worse under the DC plan than under the DB plan, will undoubtedly increase the potential liability exposure of SERS and PSERS, and indirectly the Commonwealth and school districts. Individuals who choose (or who are forced to accept) a DC plan will compare their own result to that of similarly situated employees under the DB plan, and will be quick to blame SERS and PSERS for any deficiency.

The individuals will likely claim that: (1) the investment choices offered by the Systems under the DC plan were themselves not sufficiently diversified or appropriate; (2) the Systems were negligent in selecting and monitoring the DC plan providers; or (3) the Systems did not adequately advise the individuals about their investment choices. *See* Regina T. Jefferson, "Rethinking the Risk of Defined Contribution Plans," 4 Fla. Tax Rev. 607, 630 (2000).

PSERS and SERS will be exposed to these types of suits under the Commonwealth Tort Claims Act, 42 Pa.C.S. §8521 et seq. In *Potter v. Springfield Township,* 681 A.2d 241 (Pa. Cmwlth. 1996), *appeal denied,* 547 Pa. 760, 692 A.2d 568 (1997) (involving a suit under the virtually identical Political Subdivision Tort Claims Act), members of the Township Pension Fund sought

[3] Among the advantages of a DC plan are: (1) easier and less costly to administer; (2) easy to explain to employees; (3) provides greater portability; and (4) has more immediate vesting. Among the disadvantages of a DC plan are: (1) lump sum distributions of entire benefit tends to dissipate the assets more quickly; (2) women have a greater likelihood of outliving their benefit; (3) lack of disability annuity benefit; (4) generally poorer investment rates of return; and (5) no provision for cost of living adjustments.

to compel the Pension Fund Trustees to refund money stolen by the Pension Fund Administrator, who had been hired by the Trustees. The complaint asserted that the Trustees failed to make reasonable and prudent efforts to ensure that the Pension Fund was adequately and soundly managed. The Court held that the Trustees were not liable for theft of funds under the Tort Claims Act because the Act applied only to negligent conduct, not criminal conduct. The implicit holding of the Court, however, is that trustees of pension plans will be held liable for the negligent conduct of third parties hired to administer the plan.[4]

Because the Commonwealth guarantees the DB pension benefit, and the Systems can spread out any loss incurred by a specific fund manger across the entire fund over a significant period of time, both PSERS and SERS are far less likely to be sued under the current structure by members. Indeed, individual members cannot pursue a claim, absent a showing that any such loss has actually impaired their ability to receive a benefit. *Compare Geary v. Allegheny County Retirement Board*, 426 Pa. 254, 231 A.2d 743 (1967) (theoretical possibility that payments will not be met does not give rise to cause of action) *with Dombrowski v. City of Philadelphia*, 431 Pa. 199, 245 A.2d 238 (1968) (individual member could pursue claim where the system was actually and presently unsound as a result of failure of city to appropriate sufficient funds). Under a DC plan, however, individual members are more likely to suffer a loss of benefits as a result of the mismanagement, because their funds are more directly tied to the performance of the particular manager with whom they have invested.

<u>Direct Employer Liability</u>

A similar legal analysis also exposes the employers in a DC plan to potential direct liability for failure to make required employer or employee contributions. One advantage of DB plans is that there are a variety of actuarially accepted funding methods and time periods. As a result, employers have some flexibility in determining how much cash needs to be contributed to the plan each funding cycle. Additionally, if any given payment of employer contributions is delayed, the Commonwealth guarantee of SERS and PSERS benefits, and the self-adjusting mechanism of the DB actuarial process, in which unfunded liabilities are paid for through future adjustments of employer contributions, mitigates against the ability of the plan participants to successfully proceed against an employer who has failed to make timely employer contributions.

Under a DC plan, however, employer contributions are a fixed percentage of compensation. There is virtually no flexibility for sponsors or employers to adopt funding methods or time periods to accommodate the fiscal needs of the employers. Employer failure to make the established contributions on time may expose the employers or the governmental sources of funding to direct liability in actions by the participants. Additionally, because of the fiduciary status of the Retirement Boards as trustees for the DC plan members, the Retirement Boards may themselves be compelled as a matter of law to institute action against non-performing employers.

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[4] When trustees are sued in their official or individual capacity, the Commonwealth normally indemnifies the trustees for any judgment and expenses arising out of their negligent or unintentional conduct, if they were acting within the scope of their authority and in an official capacity. *See* 4 Pa. Code §39.2. It is also possible for the General Assembly to reinstitute sovereign immunity for such conduct.

See e.g. Dadisman v. Moore, 384 S.E. 2d 816 (W.Va. 1988) (failure of the Board to file suit to force the Legislature to properly fund the pension plan constituted a breach of fiduciary duties). This in turn raises practical and public policy issues under the Commonwealth Attorneys Act, Act of Oct. 15, 1980, P.L. 950, No. 102, 71 P.S. §§732-101 to 732-506.

There is also the issue of the timing of employer and employee contributions as a result of changes in employment status. In a DB plan, with a fixed rate of interest, the timing of the contributions is largely irrelevant. In a DC plan, however, employees who do not have timely contributions made may seek lost opportunity earnings as part of damages in any suit or labor action against the employer. The failure to make the required employer and employee contributions may stem from as routine a matter as disputes over dismissal, reclassification or promotion. SERS and PSERS both envision that DC covered employees, who receive back pay awards on reclassification or reemployment, would seek not only the retroactive employer contributions, but also any investment returns that would have been realized had those contributions been timely made.

Education Programs

The Systems can reduce their risk of exposure by adopting a comprehensive education program describing the options available to the members. While the Systems must provide sufficient information under such a program to enable the members to make sound investment decisions, nevertheless the Systems must at the same time be careful not to render investment advice. The Systems can be held liable as a fiduciary for rendering investment advice that later proves to be incorrect or incomplete. *See, e.g.,* Mary Rowland, "Educate or Litigate: Educating Pension Plan Participants," Institutional Investor, March 1, 1995.

While "investment advice" and "investment information" can be differentiated,[5] nevertheless many individuals, who are unsophisticated investors, may, as a practical matter, be unable to distinguish between investment advice and an investment recommendation. For example, the aggressive marketing of certain investments by the approved broker or DC plan provider may be interpreted by the individual as investment advice rather than general information. *See* Jefferson, "Rethinking the Risk of Defined Contribution Plans," *supra,* at 632. If the individual relies on the information and fares poorly, the risk of suit against the Systems is increased.

The Systems can also reduce their liability exposure by adopting the substantive rules and regulations of a "safe harbor" plan under section 404(c) of ERISA, 26 U.S.C. §1104(c).[6] The

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[5] Investment advice consists of recommendations pertaining to property value; investment information consists of mere information that is general in nature. Thus, providing a list of investment vehicles and instructions about the investment selection process is likely to be considered investment information, while specific recommendations about particular investments is likely to be considered investment advice. Jefferson, *supra*, at 631.

[6] Although governmental plans are not subject to ERISA, 29 U.S.C. §1004(b)(1), nevertheless a plan meeting these requirements would probably survive a breach of fiduciary liability challenge.

404(c) Regulations, contained at 29 C.F.R. §2550.404c-1 et seq., provide that plan fiduciaries will avoid liability for investment decisions of individuals under a DC plan if the plan offers "an opportunity to choose from a broad range of investment alternatives," defined as alternatives sufficient to provide the participant with a reasonable opportunity to:

(1) Materially affect the potential return;
(2) Choose from at least 3 investment alternatives:
    a. Each of which is diversified;
    b. Each of which has materially different risk and return characteristics;
    c. Which in the aggregate enables the participant to achieve a portfolio with aggregate risk and return characteristics within the normal range appropriate for the participant; and
(3) Diversify the investment to minimize the risk of large losses.

See 29 C.F.R. §2550.404c-1(b)(3). Adoption of such a plan is not fool proof, however. A plan fiduciary will retain liability for exercising improper influence or concealment of material nonpublic facts known by the fiduciary, or for taking instructions from a participant that is known by the fiduciary to be legally incompetent. 29 C.F.R. §2550.404c-1(c)(2). Moreover, plan fiduciaries are still liable for failure to ensure that the investment options offered are sound and that the investment managers selected are competent. 29 C.F.R. §2550.404c-1(a)(2). *See also* "Investments: Pension Plan Participants Need Education on Investments," 21 Pens. & Ben. Rep. (BNA) 775 (Apr. 18, 1994).

We also note that, on February 4, 2002, HR 3669 was introduced in Congress, entitled the "Employee Retirement Savings Bill of Rights." Under this proposal, certain pension plans would be required to notify each individual in a plan of "generally accepted investment principles, including principles of risk management and diversification." §4980G(e)(1). Although this proposal does not generally apply to governmental plans such as PSERS and SERS, nevertheless the proposal does apply to governmental 457 plans and 403(b) plans, and the proposal might be expanded to include all governmental plans with DC components.

Any educational program, of course, will be an expensive undertaking. The significant cost involved will have an impact on the Systems' finances. As discussed in the succeeding sections, this cost cannot come from the Systems' DB plan assets, but must be separately provided for under any legislation establishing a DC plan.[7]

[7] *See, e.g.,* 19 Montana Statutes §19-3-112(c). Montana, which has a DB retirement system for its public employees, recently enacted legislation to allow members to opt into a newly created DC plan. As part of this legislation, the Legislature established a separate contribution rate of 0.04% to pay for an education program for the DC plan alternative.

Potential Contract Impairment and Due Process Issues

Generally, public retirement benefits are viewed as deferred compensation for work already performed, which confers upon public employees contractual rights protected by both the United States (Article 1, section 10) and Pennsylvania (Article I section 17) Constitutions.[8] *Police Officers of Hatboro v. Borough of Hatboro,* 559 A.2d 113 (Pa. Cmwlth 1989); *McKenna v. State Employees' Retirement Board,* 495 Pa. 324, 433 A.2d 871 (1981); *Catania v. State Employees' Retirement Board,* 498 Pa. 684, 450 A.2d (1982). These contractual pension rights become fixed upon the employee's entry into the system and cannot be subsequently unilaterally diminished or adversely affected, regardless of whether (1) the member is vested; or (2) the devaluation is necessary for actuarial soundness. *Association of Pa. State College and University Faculties v. State System of Higher Education,* 505 Pa. 369, 479 A.2d 962 (1984). *See also Hughes v. Public School Employees' Retirement Board*, 662 A.2d 701 (Pa. Cmwlth. 1995), *alloc. denied,* 542 Pa. 678, 668 A.2d 1139 (1995) (member has property interest in pension benefit).

Related to this concept is the Fourteenth Amendment of the United States Constitution, which prevents states from depriving a person of life, liberty, or property without due process of law. This procedural protection of property is a safeguard of the security of interests that a person has already acquired in specific benefits. *Board of Regents v. Roth,* 408 U.S. 564 (1977).

Any legislation establishing a DC plan that allows existing members to transfer assets (including employer contributions, employee contributions and investment returns on such contributions) contained in the DB plan to the newly created DC plan might have an impact on the actuarial soundness of the plan. This impact might also have an effect on the contractual and due process rights of the remaining members.

This claim, in fact, was made successfully by the Milwaukee County Pension Board in *Association of State Prosecutors v. Milwaukee County, et al.,* 199 Wis. 2d 549, 544 N.W. 2d 888 (1996), a case involving the Wisconsin Retirement System (State Plan). The Legislature, wanting to create a uniform statewide pension for all county prosecutors, enacted legislation requiring all prosecutors to become state employees (rather than county employees). The legislation also allowed existing prosecutors the option to remain in the county pension system (County Plan) or to transfer to the State Plan. Those who were not yet vested in the County Plan could transfer to the State Plan all employer contributions made on their behalf, along with accrued interest, from the County Plan.

The County Plan refused to transfer the funds, arguing that such a transfer would misappropriate funds held in trust exclusively for the benefit of vested employees, thereby impairing their right to receive a benefit. The Court agreed with the County Plan and declared the legislation unconstitutional. The Court's reasoning is instructive:

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[8] The U. S. Constitution provides: "No state shall … pass any … Law impairing the Obligation of Contracts … ." The Pa. Constitution provides: "No ex post facto law, nor any law impairing the obligations of contract, … shall be passed."

> Any pension plan's ability to meet its obligations can be jeopardized when funds are taken from it, since every dime is arguably part of a management strategy dependent upon spreading the fund's monies as broadly as possible. …
>
> The Association contends that, since the contributions to be transferred make up less than one-third of one percent of the County Plan's net assets, the transfer will not diminish or "take" the benefits of County Plan employees and retirees. We disagree. Governmental takings do not become exempt from due process requirements simply because they may be actuarially insignificant. …
>
> While the specific transfer of trust funds … may not immediately threaten the benefits of vested County Plan beneficiaries, the precedent set by such a transfer certainly could. … If the legislature orders contributions made "on behalf of" employees to be transferred to such new employers, the actuarial soundness of the plan could eventually suffer. …
>
> [W]e hold that vested employees and retirees have protectable property interests in their retirement trust funds which the legislature cannot simply confiscate under the circumstances of this case.

Id. at 892-896 (citations omitted). *See also Resolution Trust Corp. v. Financial Institutions Retirement Fund*, 71 F.3d 1553 (10th Cir. 1995) (employer withdrawing from a multi-employer pension plan was not permitted to withdraw its portion of a future employer contribution offset because such withdrawal would diminish the pension fund assets, a risk not tolerable under the exclusive benefit rule). The reasoning of these cases may be equally applicable to Pennsylvania, because, as noted above, Pennsylvania has also held that employees have a property interest in their retirement benefits. The existence of the Commonwealth guarantee, however, will mitigate against this type of claim.

We should note that the current version of SB 486, P.N. 513, amending the SERS Retirement Code, and SB 487, P.N. 514, amending the PSERS Retirement Code, limits the DC plan option to <u>new employees</u> only. Although such limitation will avoid the argument raised in Wisconsin, nevertheless such legislation will still impair the actuarial soundness of the Systems, because future employees, who would otherwise have been mandatory members of, and contributing to, the Systems, will be excluded, thereby reducing the ability of the Systems to fund benefits.

This issue has been addressed by Montana, which recently added a DC plan alternative to their DB plan System. Montana has created a separate "plan choice rate" in the amount of 2.37% of compensation, to be added to the employer contribution rate. This plan choice rate, which will be adjusted from year to year, is designed to make up for the loss of contributions resulting from: (1) losses caused by current members transferring to the DC plan; and (2) losses caused by new members joining the DC plan that would have been required to join the DB plan. *See* 19 Montana Statutes, §19-3-2121. Through this provision, Montana can avoid the impairment issue, because the state, by paying the loss caused by members opting into the DC plan, has expressly kept the DB system from suffering any loss.

Impact on Fiduciary Responsibility

In determining the impact of a DC plan alternative on the Systems' fiduciary responsibilities, one must first understand the nature and extent of that duty as it exists today.

Fiduciary Standards

The Retirement Codes impose a fiduciary relationship on the Boards and its officers and employees with respect to the members of the system.[9] Under common law, fiduciaries owe two basic duties to the members of the System: (1) the duty of loyalty; and (2) the duty of prudence.

Duty of Loyalty

The duty of loyalty has been described as follows:

> [T]he most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty. This duty is imposed upon the trustee not because of any provision in the terms of the trust but because of the relationship which arises from the creation of the trust.

A. Scott, Law of Trusts § 170 at 1297 (3d Ed. 1967). This duty of loyalty means that "the trustee owes a duty to the beneficiaries to administer the affairs of the trust in the interest of the beneficiaries alone, and to exclude from consideration his own advantages and the welfare of third persons. G. Bogert & G. T. Bogert, Handbook on the Law of Trusts, § 95 at 343 (5th Ed. 1973). Thus, fiduciaries must seek out the course of conduct that will best serve the interests of the beneficiary.

The Internal Revenue Code also imposes a similar duty, known as the "exclusive benefit rule," upon the Systems' trustees. In fact, the exclusive benefit rule must be followed if the Systems want to retain their tax-qualified status. This rule is reproduced below:

> **401. Qualified pension, profit-sharing, and stock bonus plans.**
> **(a) Requirements for qualification**.--A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section--
>
> * * *
>
> (2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter)

[9] *See* PSERS Retirement Code, 24 Pa. C.S. §8521(e) and SERS Retirement Code, 71 Pa. C.S. §5931(e) ("The members of the board, employees of the board, and agents thereof shall stand in a fiduciary relationship to the members of the system regarding the investments and disbursements of any of the moneys of the fund …).

> used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries . . .

26 U.S.C. § 401(a)(2).

Duty of Prudence

The standard of care to which the Systems' Boards are subject is commonly known as the "prudent person rule." This Rule was first announced in a decision by the Supreme Judicial Court of Massachusetts in *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1831), in which the Court explained:

> All that can be required of a trustee to invest is that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested. Thus, courts focus on the conduct of trustees of selecting investments rather than the investment performance results.

This Rule has been adopted in Pennsylvania. *Estate of Stetson,* 463 Pa. 64, 345 A.2d 679 (1975). The Rule has also been expressly incorporated into the Retirement Codes, 24 Pa.C.S. §8521(a); 71 Pa.C.S. §5931(a), as well as the Probate, Estates and Fiduciaries Code. 20 Pa.C.S. §7302(a).

Impact on Fiduciary Responsibility

Establishment of a DC plan, either as a supplement to the existing DB plan or as an alternative to the existing DB plan, would not, in and of itself, alter the level or degree of fiduciary responsibility imposed upon the Boards. Creation of such a plan would, however, expand the range of the Boards' fiduciary responsibilities. The real question, then, is whether the expanded scope of responsibility adversely impacts the Boards' ability to manage the existing DB plan.

In this regard, the Boards must insure that the DC plan, upon adoption, will not affect the operation or the finances of the DB plan. As discussed above, any outflow of funds caused by members selecting or opting into the DC plan must be made up by the Legislature. Otherwise, the funds' actuarial soundness, and the Boards' entire investment strategy, will be impaired.

To the extent that the Systems must use funds allocated to the DB plan to operate the DC plan, the Systems may be in danger of violating the exclusive benefit rule. *See, e.g. Resolution Trust Corporation v. Financial Institutions Retirement Fund*, 71 F.3d 1553 (10th Cir. 1995) (the exclusive benefit rule is violated where plan assets are used for the benefit of anyone other than the plan participants). This argument will apply more directly if the DC plan is an alternative to the DB plan, rather than a supplement to the DB plan. If the DC plan is an exclusive alternative, then arguably the plan participants in the DB plan are not the same as the participants in the DC plan. *See e.g.,* PSERS Retirement Code §§8902(a) and 9101(d) (health insurance program funds must be maintained separately from all other retirement funds).

Conclusion

We have analyzed the exposure to liability on the part of the Commonwealth and school employers, as well as the Retirement Systems, arising out of legislation providing employees the choice of joining a DC plan. We have concluded that establishment of a DC plan, either as a supplement, or as an alternative, to the existing DB plans, will increase the potential liability of the Systems, the Commonwealth and the public school districts. Potential claims include the lack of diversity in the choice of approved plans, negligence in selecting and monitoring plan providers, and inadequate advice about the various investment choices.

We have also analyzed the impact of the establishment of a DC plan on fiduciary duties of the Commonwealth, school employers and the Retirement Systems. We have concluded that there are contract impairment and due process issues in connection with the establishment of a DC plan, especially if no provisions are made for the loss of contributions caused by members electing into the DC plan, and for the additional educational expense that will be incurred by the Systems to explain the DC plan choices.

Bill ID: House Bill Number 9, Printer's Number 2205

System: State Employees' Retirement System

Subject: Membership in the State Employees' Retirement System for Individuals Employed as "Crewleaders" with the Pennsylvania Conservation Corps

SYNOPSIS

House Bill Number 9, Printer's Number 2205, would amend the Pennsylvania Conservation Corps Act (Act of 1984, P. L. 561, No. 112) to entitle "crewleaders" of the Pennsylvania Conservation Corps to membership in the State Employees' Retirement System beginning July 1, 2009. The bill also mandates expiration of the Pennsylvania Conservation Corps Act and the Pennsylvania Conservation Corps on June 30, 2020.

DISCUSSION

The State Employees' Retirement Code (Code) is a governmental, cost-sharing, multiple-employer pension plan. The designated purpose of the State Employees' Retirement System (SERS) is to provide retirement allowances and other benefits, including disability and death benefits to State employees. Membership in SERS is mandatory for most full-time State employees. Certain other employees are not required but are given the option to participate. As of December 31, 2009, SERS had 110,458 active members and 109,639 annuitants and beneficiaries.

Under the 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 Code also have permitted members with 30 or more years of service credit to retire at any age and receive full retirement benefits with no benefit reduction for retiring prior to the superannuation or normal retirement age. The most recent special early retirement provision expired June 30, 1999.

Pennsylvania Conservation Corps

The Pennsylvania Conservation Corps (PCC) was created in July 1984 by the Pennsylvania Conservation Corps Act (Act 112 of 1984). Administered by the Department of Labor and Industry, the mission of the PCC is to develop the workplace skills, life skills and self-confidence of corps members, and to instill in corps members a sense of citizenship and community service through participation in conservation projects, historical work and various other projects of public benefit. Since 1984, the PCC has undertaken more than 1,000 projects in urban, suburban and rural areas statewide. Entities that are eligible to sponsor PCC projects include: local governments; community-based non-profit organizations; the Pennsylvania Emergency Management Agency; the Pennsylvania Game Commission; the Pennsylvania Fish and Boat Commission; the Historical and Museum Commission; and the Departments of Aging, Corrections, Education, Public Welfare, Military and Veterans Affairs, Community and Economic Development, and Conservation and Natural Resources.

Corps members are Pennsylvania residents, between the ages of 18 and 25 (16 and 17 year-olds may participate under special circumstances). Preference in enrollment is given to the economically disadvantaged. Corps members enroll for an initial one-year term of service, with the possibility of extending for an additional six to twelve months of service. Corps members receive a starting salary of $7.25 per hour, with a 10 percent pay increase after six months on the job. Corps members who complete a year of service are eligible to receive a one-time cash bonus of $1,000, and may also qualify for an education award of up to $4,725. While enrolled, Corps members receive on-the-job vocational training, including carpentry, masonry, electrical work, landscaping and a variety of other trades. Corps members work in crews under the supervision of crewleaders who have experience in the building trades and are skilled in motivating and training young adults.

Crewleaders are supervisory personnel employed by the Department of Labor and Industry pursuant to the Pennsylvania Conservation Corps Act. To be eligible for employment as a crewleader, an individual must be a Pennsylvania resident, be registered with the local Job Center for employment, and be physically and mentally capable of performing labor intensive work and supervisory duties. Crewleader candidates are referred to the PCC by the Bureau of State Employment, and preference in hiring is given to honorably discharged military veterans. Crewleaders are full-time, temporary employees, and currently receive a starting wage of $12.35 per hour, with an increase to $12.96 an hour after six months on the job. Examples of work performed by crewleaders include: interviewing and enrolling corps members, planning, organizing, scheduling and assigning work to corps members, directing crew activities, evaluating corps members' work performance, and compiling and submitting periodic reports. Crewleaders are initially employed for a one-year term of service, which may be extended, at the option of the Department of Labor and Industry, for an unlimited number of additional one-year terms. Despite their full-time status, however, crewleaders are not entitled to membership in SERS, nor most other employee benefits normally provided to regular Commonwealth employees, except for paid Commonwealth holidays and workmen's compensation.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary indicated that enactment of the bill would create an unfunded actuarial accrued liability. The additional liability results because the assumed average attained age of the affected employees as of July 2009 was 46, which is significantly higher than the average age (35) of a new entrant to SERS (upon whom the normal cost rate is based). Therefore, the present value of future normal costs, which are based on the average SERS new entrant, will not fully cover the present value of future benefits for the 49 members expected to join SERS as a result of enactment of the bill.

Additional amortization payments would be necessary to fund any increase in unfunded actuarial accrued liability. By law, benefit changes must be funded over a 10-year period through level-dollar amortization payments. However, because the bill would not institute a benefit change, but would instead add an additional cohort of membership to the system, the consulting actuary for SERS has advised the Commission staff that the increase in liability attributable to the bill would be treated as an experience loss and amortized through level-dollar amortization payments over 30 years instead of 10 years. The estimated change in normal cost is shown in the following table.

	Amount
Change in Unfunded Actuarial Accrued Liability	$231,000

	Amount	As a % of Affected Payroll
Additional Employer Annual Costs		
Normal Cost	$120,000	9.51%
Amortization Payment [1]	20,000	1.59%
Total Additional Increase in Employer Annual Costs	$140,000	11.10%

[1] Level-dollar amortization payments over a thirty-year period.

POLICY CONSIDERATIONS

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

Drafting Irregularity. The bill amends the Pennsylvania Conservation Corps Act to provide for membership in SERS without amending the applicable retirement statute. It is unusual and irregular to provide for retirement benefits by amending a statute other than the applicable retirement Code. The bill would entitle crewleaders to membership in SERS beginning July 1, 2009. However, the bill is silent on the precise nature of that membership. The bill does not specify whether membership in SERS would be mandatory (as is the case for most Commonwealth employees) or if membership would be optional. House Bill Number 9 should be amended to make the entitlement to SERS membership contingent upon a corresponding amendment to the SERS Code which would specify the nature of SERS membership. Such an amendment would alleviate the Commission's concern about creating a pension entitlement in a non-pension statute. The staff believes that the following suggested language would adequately address this concern:

> On bill page 2, line 21, insert after "System" "if so provided in Section 5301 (pertaining to Mandatory and Optional Membership) of Title 71 (State Government) of the Pennsylvania Consolidated Statutes."

Mandatory and Optional Membership. Section 5301 of the SERS Code addresses the issue of System membership. While the bill itself is silent on whether membership would be mandatory or optional for the affected group of employees, for most full-time State employees of Commonwealth departments, membership in SERS is mandatory. Certain other employees, including the Governor, members of the General Assembly, and heads of departments and commissions, have the option to become members, but are not required to do so. Others, including most part-time employees, are specifically excluded from membership in SERS. The Pennsylvania Conservation Corps Act defines crewleaders as full-time, temporary employees of the Department of Labor and Industry. The General Assembly and the Governor must determine whether mandatory or optional membership in SERS is appropriate for this class of employee.

Potential for Additional Retirement Benefit Costs. If the bill is enacted, there may be additional retirement benefit costs incurred by the Commonwealth. By becoming members of SERS, the affected employees may become eligible to purchase service credit in SERS for previous nonstate service. Through the purchase of additional service credit, a member either may become eligible for superannuation retirement benefits sooner than otherwise or may achieve eligibility for such benefits when the member could not otherwise do so. There may also be ancillary costs to the Commonwealth resulting from enactment of the bill, such as payments for unused accrued leave or eligibility for employer-subsidized postretirement healthcare benefits.

Drafting Issue. The bill would entitle crewleaders to membership in SERS beginning July 1, 2009. As written, the bill could be interpreted as providing retroactive membership in SERS. If the intent of the bill is to provide SERS membership on a prospective basis only, the bill should be amended to provide SERS membership beginning July 1, 2010 (see bill page 2, line 20, and bill page 3, line 8).

COMMISSION RECOMMENDATION

On March 3, 2010, 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

A later version of House Bill Number 9 was signed into law by the Governor on June 29, 2010.

Bill ID: House Bill Number 2324, Printer's Number 3349

System: Cities of the Second Class A (Scranton) Employees' Retirement Systems (Uniformed Employees)

Subject: Eligibility for Purchase of Nonintervening Military Service

SYNOPSIS

House Bill Number 2324, Printer's Number 3349, would amend the act of July 3, 1947 (P. L. 1242, No. 507), which is the statute establishing the pension plans for police officers and firefighters in the City of Scranton. The act permits a uniformed employee of either the police or firemen's pension plans to purchase up to five years of nonintervening military service if the member enters employment with the City of Scranton within three years of the date of the member's release from active military service. The bill would amend the Act by removing the statutory three-year time limit within which a member must commence employment with the City following military service in order to be eligible to purchase credit for nonintervening military service, and by mandating that moneys be appropriated by the City to the pension plans to enable the purchase of military service credit. House Bill Number 2324, Printer's Number 3349, is a companion bill to House Bill Number 2325, Printer's Number 3350, which would similarly amend the pension statute affecting nonuniformed employees of the City of Scranton.

DISCUSSION

The act of July 3, 1947 (P. L. 1242, No. 507) establishes the pension plan for uniformed (police and fire) employees in the City of Scranton. The City of Scranton Police Pension Plan is a contributory, defined benefit pension plan. For police officers hired prior to July 1, 1987, the normal retirement age is age 65 or any age upon the completion of 25 years of service. The normal retirement benefit for members who have attained age 65 is equal to 2% for each year of service based upon the salary being received at retirement, up to a maximum of 50% of salary. The normal retirement benefit for members who have not attained age 65 is 50% of the salary paid to the member at the highest grade held by the member at retirement. For police officers hired on or after July 1, 1987, normal retirement age is age 55 and 25 years of service. The normal retirement benefit is 50% of the member's average monthly salary based upon the final 36 months of employment. As of January 1, 2009, there were 156 active members of the plan.

The City of Scranton Firemen's Pension Plan is a contributory, defined benefit pension plan. For firemen hired prior to July 1, 1987, the normal retirement age is any age upon the completion of 25 years of service. The normal retirement benefit is equal to 50% of the member's salary at retirement, plus a service increment of 0.5% per year, payable in five-year increments, for service in excess of 25 years. For firemen hired on or after July 1, 1987, normal retirement age is age 55 with 25 years of service, and the normal retirement benefit is equal to 50% of the member's average monthly salary based upon the final 36 months of employment. As of January 1, 2009, there were 143 active members of the plan.

One of the most common service purchase authorizations provided by public employee retirement systems is for periods of military service which interrupt or delay the commencement of a career with the public employer. Permitting a member to receive retirement service credit for military service is of benefit to the member because the member's retirement benefit can be enhanced through the acquisition of additional service credit, and, in some cases, retirement eligibility can be accelerated.

In 1994, the United States Congress passed the Uniformed Services Employment and Re-employment Rights Act (USERRA), which replaced the former Veterans' Reemployment Rights Law (VRRL). To ensure that they are not held at a disadvantage in their employment rights, USERRA requires that all employees rendering intervening military service (service that interrupts employment) be considered as having been on leave of absence during that time, a policy that is also reflected in the Commonwealth of Pennsylvania's Military Code and in most state pension plan statutes (USERRA does not address the issue of *nonintervening* military service.). Specifically, 38 U. S. C. § 4318(a)(2)(A) provides that the employee "shall be treated as not having incurred a break in service . . . by reason of such person's period or periods of service." Further, § 4318(b)(1) provides that "[a]n employer . . . shall . . . be liable to an employee pension benefit plan for funding any obligation of the plan to provide the benefits described in subsection (a)(2) . . . ," and that "[n]o such payment may exceed the amount the person would have been permitted or required to contribute had the person remained continuously employed by the employer" (§ 4318(b)(2)).

In addition to service credit for intervening military service (covered by USERRA), the statute governing the pension plans for uniformed employees in the City of Scranton permits an active member of the pension plan to purchase up to five years of nonintervening military service (military service performed prior to commencement of employment) if the member entered employment with the City within three years of the date of the member's release from active military service. The bill would amend the statute by removing the three-year time limit within which a member must commence employment with the City following military service in order to be eligible to purchase credit for nonintervening military service, and by mandating that affected members be entitled to purchase the nonintervening military service credit.

Permitting a member to receive retirement service credit for nonintervening military service has been a longstanding policy among the major public employee retirement systems of the Commonwealth. The currently mandated three-year time limit appears arbitrary, and is a condition not imposed by any other state or municipal pension statute. There is no reasonable public pension policy rationale for making eligibility for the purchase of nonintervening military service contingent upon the expanse of time between when an individual left the military and became a public employee of the City. If the purchase of nonintervening military service is to be permitted, all such service should be treated equally. The bill, therefore, seeks to remove an inequity in the crediting of nonintervening military service that currently exists in the statute governing police and firemen retirement systems of the City.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary reviewed the bill and determined that because an eligible member would be required to purchase nonintervening military service by making a payment to the pension fund that is equal to the amount the member would have contributed had the member been a member of the pension fund during the period of nonintervening military service, plus the equivalent of the City's contributions on account of such service, there should be no actuarial cost to the City resulting from enactment of the bill.

POLICY CONSIDERATIONS

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

> Equity in the Crediting of Military Service. Permitting a member to receive retirement service credit for military service has been a longstanding policy among the major public employee retirement systems of the Commonwealth. The bill removes statutory language that currently treats nonintervening military service inequitably for retirement credit purposes.

COMMISSION RECOMMENDATION

On May 27, 2010, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issue identified in the actuarial note transmittal.

FINAL LEGISLATIVE STATUS

House Bill Number 2324, Printer's Number 3349, had first consideration on September 28, 2010, and was re-referred to the House Appropriations Committee.

Bill ID: House Bill Number 2325, Printer's Number 3350

System: Cities of the Second Class A (Scranton) Employees' Retirement System (Nonuniformed Employees)

Subject: Eligibility for Purchase of Nonintervening Military Service

SYNOPSIS

House Bill Number 2325, Printer's Number 3350, would amend the Second Class A City Employe Pension Law by removing the statutory three-year time limit within which a member must commence employment with the City of Scranton following military service in order to be eligible to purchase credit for nonintervening military service, and by mandating that affected members be entitled to purchase the nonintervening military service credit. House Bill Number 2325, Printer's Number 3350, is a companion bill to House Bill Number 2324, Printer's Number 3349, which would similarly amend the pension statute affecting uniformed (police and fire) employees.

DISCUSSION

The Second Class A City Employe Pension Law (Act of September 23, 1959, P. L. 970, No. 400) establishes the pension plan for nonuniformed employees in the City of Scranton. The City of Scranton Nonuniformed Pension Plan is a contributory, defined benefit pension plan. Normal retirement age is age 55 with at least 15 years of service. As of January 1, 2009, there were 180 active members of the plan.

One of the most common service purchase authorizations provided by public employee retirement systems is for periods of military service which interrupt or delay the commencement of a career with the public employer. Permitting a member to receive retirement service credit for military service is of benefit to the member because the member's retirement benefit can be enhanced through the acquisition of additional service credit, and, in some cases, retirement eligibility can be accelerated.

In 1994, the United States Congress passed the Uniformed Services Employment and Re-employment Rights Act (USERRA), which replaced the former Veterans' Reemployment Rights Law (VRRL). To ensure that they are not held at a disadvantage in their employment rights, USERRA requires that all employees rendering intervening military service (service that interrupts employment) be considered as having been on leave of absence during that time, a policy that is also reflected in the Commonwealth of Pennsylvania's Military Code and in most state pension plan statutes (USERRA does not address the issue of *nonintervening* military service.). Specifically, 38 U. S. C. § 4318(a)(2)(A) provides that the employee "shall be treated as not having incurred a break in service . . . by reason of such person's period or periods of service." Further, § 4318(b)(1) provides that "[a]n employer . . . shall . . . be liable to an employee pension benefit plan for funding any obligation of the plan to provide the benefits described in subsection (a)(2) . . . ," and that "[n]o such payment may exceed the amount the person would have been permitted or required to contribute had the person remained continuously employed by the employer" (§ 4318(b)(2)).

In addition to service credit for intervening military service (covered by USERRA), the Second Class A City Employe Pension Law permits an active member of the pension plan to purchase up to five years of nonintervening military service (military service performed prior to commencement of employment) if the member entered employment with the City of Scranton within three years of the date of the member's release from active military service. The bill would amend the Second Class A City Employe Pension Law by removing the statutory three-year time limit within which a member must commence employment with the City following military service in order to be eligible to purchase credit for nonintervening military service, and by mandating that affected members be entitled to purchase the nonintervening military service credit.

Permitting a member to receive retirement service credit for nonintervening military service has been a longstanding policy among the major public employee retirement systems of the Commonwealth. The currently mandated three-year time limit appears arbitrary, and is a condition not imposed by any other state or municipal pension statute. There is no reasonable public pension policy rationale for making eligibility for the purchase of nonintervening military service contingent upon the expanse of time between when an individual left the military and became a public employee of the City. If the purchase of nonintervening military service is to be permitted, all such service should be treated equally. The bill, therefore, seeks to remove an inequity in the crediting of nonintervening military service that currently exists in the Second Class A City Employee Pension Law.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary reviewed the bill and determined that because an eligible member would be required to purchase nonintervening military service by making a payment to the pension fund that is equal to the amount the member would have contributed had the member been a member of the pension fund during the period of nonintervening military service, plus the equivalent of the City's contributions on account of such service, there should be no actuarial cost to the City resulting from enactment of the bill.

POLICY CONSIDERATIONS

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

> Equity in the Crediting of Military Service. Permitting a member to receive retirement service credit for military service has been a longstanding policy among the major public employee retirement systems of the Commonwealth. The bill removes language in the Second Class A City Employe Pension Law that currently treats nonintervening military service inequitably for retirement credit purposes.

COMMISSION RECOMMENDATION

On May 27, 2010, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issue identified in the actuarial note transmittal.

House Bill Number 2325, Printer's Number 3350, had first consideration on September 28, 2010, and was re-referred to the House Appropriations Committee.

Bill ID: House Bill Number 2497, Printer's Number 3730

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

Subject: Modification of Actuarial Funding Requirements

SYNOPSIS

House Bill Number 2497, Printer's Number 3730, would amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) to modify the actuarial funding requirements of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS).

The bill would amend the Public School Employees' Retirement Code to:

1) Beginning July 1, 2011, re-amortize all of the unfunded actuarial accrued liabilities of PSERS over a 30-year period using level percentage of pay amortization payments;

2) Beginning July 1, 2011, extend from five years to ten years the asset smoothing period over which the fund's investment gains and losses are recognized;

3) Fund any increases in accrued liability enacted by legislation subsequent to June 30, 2010, over a 10-year period using level percentage of pay amortization payments;

4) For the fiscal year beginning July 1, 2010, establish the total employer contribution rate as the "final contribution rate" of 5.0% of the total compensation for all active members, plus the premium assistance contribution rate;

5) Modify employer contribution requirements to PSERS by imposing limits, referred to as "collars" on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total compensation of all active members greater than the prior year's final contribution rate, then the collared contribution rate shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total compensation for all active members; and

6) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate.

The bill would amend the State Employees' Retirement Code to:

1) Beginning July 1, 2010, re-amortize all of the unfunded actuarial accrued liabilities of SERS, including previously enacted supplemental annuities, over a 30-year period using level percentage of pay amortization payments;

2) Maintain the current five-year smoothing period over which investment gains and losses are recognized;

3) Fund any increase in accrued liability enacted by legislation subsequent to December 31, 2009, over a 10-year period using level percentage of pay amortization payments;

4) For the fiscal year beginning July 1, 2010, establish the total employer contribution rate as the "final contribution rate" of 5.0% of the total compensation for all active members;

5) Modify employer contribution requirements to SERS by imposing limits, referred to as "collars," on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total compensation of all active members greater than the prior year's final contribution rate, then the collared contribution rate shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total compensation for all active members; and

6) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate.

DISCUSSION

The Retirement Codes and Systems

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer pension plans. The designated purpose of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS) is to provide retirement allowances and other benefits, including disability and death benefits to public school and state employees. As of June 30, 2009, there were approximately 754 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS, and approximately 107 Commonwealth and other employers participating in SERS.

Membership in PSERS and SERS 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, 2009, there were 279,701 active members and 177,963 annuitant members of PSERS, and as of December 31, 2009, there were 110,107 active members and 109,639 annuitant members of SERS. The annual retirement benefit for most members of both Systems is equivalent to the product of 2.5 percent of the member's high three-year average salary multiplied by the member's years of service.

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.

Unfunded Liabilities and Amortization Periods

Generally, the overall funding objective of a public employee pension plan is to provide reserves sufficient to fund the benefits of plan members when those benefits become due and to fund, over time, any unfunded liability through installment payments. As the funded ratio (ratio of assets to liabilities) of a pension plan declines below 100%, the plan's assets represent an increasingly smaller portion of the system's accrued liabilities. A pension trust fund in which the value of the actuarial accrued liabilities exceeds the actuarial value of assets is said to have an unfunded actuarial accrued liability. This funding shortfall may occur for many reasons, including benefit liberalizations, unfavorable investment or other actuarial experience, changes in major economic or demographic assumptions, or underfunding of the system by the employer. Based upon the June 30, 2009, actuarial valuations for PSERS, the retirement system reported unfunded actuarial accrued liabilities totaling $15.7 billion, representing a funded ratio of 79.2%. Based upon the December 31, 2009, "Valuation Highlights" provided to the Commission by SERS (the formal actuarial valuation has not yet been released), SERS reported unfunded actuarial accrued liabilities totaling $5.6 billion, representing a funded ratio of 84.4%.

The unfunded actuarial accrued liability existing in a pension trust fund must be amortized over time through installment payments. Under the Codes of both Systems, the permissible amortization periods are either 10 years or 30 years, depending upon the source of the liability. Subsequent to the passage of Act 40 of 2003, the amortization period for: 1) the increased liabilities of Act 9 of 2001; 2) the outstanding balances of the net actuarial losses incurred by PSERS in fiscal years 2000-01 and 2001-02 and by SERS in calendar year 2002; and 3) the gains and losses experienced in all future years is 30 years rather than 10 years, with the amortization contributions calculated as level-dollar payments. Amortization of the remaining balance of the pre-Act 9 of 2001 unfunded actuarial accrued liability, the future unfunded actuarial accrued liabilities attributable to benefit changes, including supplemental annuities, and in the case of PSERS, the gains and losses attributable to the change in the asset valuation methodology under Act 38 of 2002 continue to be amortized over 10 years on a level-dollar basis.

Based on current projections, the Commonwealth will experience large increases in employer contributions beginning in fiscal year 2012-2013, when the unfunded liability portion of the employer contribution rate begins to sharply increase. This employer contribution "rate spike" is the result of large unfunded liabilities generated by four major factors: 1) the two major market down turns during the past decade, from roughly 2001-2003 and again in 2008; 2) the benefit enhancement provided to active members of both PSERS and SERS by the passage of Act 9 of 2001; 3) the additional unfunded liability resulting from the two-tier cost-of-living adjustment provided to retired PSERS and SERS members by Act 38 of 2002; and 4) changes to funding methods resulting from the enactment of Act 38 of 2002 and Act 40 of 2003. Combined, Acts 38 and 40 had the effect of deferring the funding of liability. Of the two, Act 40 had the greatest impact by requiring PSERS and SERS to amortize certain gains and losses over different periods of time. Under Act 40, the recognition of pre-Act 9 gains was accelerated by amortizing these gains over a 10-year period, while the recognition of post-Act 9 losses was delayed by amortizing these losses over 30 years. The result was, in effect, a mismatch of the amortization of gains and losses, generating a 10-year credit that has suppressed the employer contribution rate and masked the true costs of the Systems. This 10-year credit will be fully amortized by fiscal year 2012-2013, which, not coincidentally, corresponds with the first year of the projected contribution rate spike.

The bill would restructure the amortization periods of both PSERS and SERS for the fiscal years beginning July 1, 2011, and July 1, 2010, respectively. The bill would require the Systems to re-amortize all of the unfunded actuarial accrued liabilities of their pension trust funds over a 30-year period. This "fresh start" of the amortization bases would have the effect of extending the amortization of the Systems' current pension liabilities, resulting in a reduction in the Systems' annual amortization contribution requirements.

The bill would also require the use of a level-percentage of pay amortization method, rather than the level-dollar method currently used by both PSERS and SERS. Compared to the level-dollar amortization method, which results in level installment payments throughout the course of the amortization period, the level-percentage of pay method will produce amortization payments that are generally lower than would be the case under the level-dollar method in the early years of the amortization period, but steadily rise by a level percentage of pay using each System's assumed annual payroll increase assumption (4.0% for PSERS and 3.3% for SERS). Although the level-percentage of pay amortization method has the advantage of helping reduce annual employer contribution requirements in the early years, this method will result in steadily escalating contribution requirements and ultimately greater total costs.

Additionally, increases in accrued liability caused by legislation enacted subsequent to June 30, 2010, for PSERS, and subsequent to December 31, 2009, for SERS, would continue to be amortized over a 10-year period, but would use level percentage of pay amortization payments instead of level-dollar payments as currently required by the Codes of both Systems.

Asset Smoothing

In public pension systems, asset "smoothing" involves the gradual recognition of investment gains and losses over time and is part of the method used to determine the actuarial value of assets in a pension trust fund. One purpose of the various smoothing methods is to avoid large year-to-year fluctuations in employer contribution requirements that may otherwise result from volatility in the investment markets.

Both PSERS and SERS currently apply a 5-year smoothing period to recognize investment gains and losses. The bill would preserve the 5-year smoothing period for SERS, but for PSERS, the bill would extend from 5 years to 10 years the smoothing period applicable to investment gains and losses. The Actuarial Standards Board (ASB) is an entity within the American Academy of Actuaries (AAA) that establishes standards of practice for the actuarial profession in the United States. Actuarial Standards of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, requires that asset smoothing methods must recognize "*the differences from the market value of assets in a sufficiently short period*." It is the professional opinion of the Commission's consulting actuary that ten years is too long a time period over which to recognize investment gains and losses because such an extended smoothing period has the potential to produce actuarial values of assets that deviate greatly from market values of assets. While the extended smoothing period would have the effect of delaying the recognition of unfavorable investment experience, it would also have the consequence of delaying recognition of favorable investment experience in future years. In the short-term, the extended smoothing period would serve to mitigate the negative effects of the unprecedented investment losses suffered by PSERS in 2008 by extending the period over which those investment losses are recognized.

Modification of Employer Contribution Requirements

PSERS and SERS are funded through: 1) employer contributions, 2) employee contributions, and 3) returns on investments. The employer normal contribution rate represents the employer portion of the value or cost (normal cost) of the benefits earned during a given year, based upon the Systems' actuarial funding methods.

Like most large defined benefit public employee retirement systems throughout the United States, PSERS and SERS both utilize variations of the entry age normal actuarial cost method. The entry age normal cost method allocates the annual cost of all future benefits to be paid by the plan by spreading those costs over the entire period of a member's service from the date of entry to the member's anticipated date of retirement. These costs are expressed both as a dollar amount and as a percentage of actual or projected payroll. This method results in the calculation of two costs: 1) the annual contributions required to establish sufficient reserves to support future retirement benefits when made from entry age to normal retirement age is the normal cost; and 2) the aggregate normal cost of all members of the plan for prior years of service is the actuarial accrued liability. If assets of the plan are less than the accrued liability, then a deficit exists. This deficit is known as an unfunded actuarial accrued liability. Because this liability has not been accounted for or funded, it must be amortized through annual payments over a specified number of years, and the required annual payments are reflected in the total determination of employer annual cost.

The employer contribution requirements for both PSERS and SERS are determined using the employer portion of the employer normal cost, plus any amortization contribution requirements necessary to amortize the unfunded liabilities of the System over the statutorily specified amortization time periods as modified by the experience adjustment factor. The experience adjustment factor is a reference to the experience of the pension funds, most importantly, the investment experience of those funds. If gains from positive plan experience are greater than expected, employer contributions may be reduced. Conversely, losses from negative plan experience require additional employer contributions to compensate for those losses.

The bill would modify the methods currently used to determine the employer contribution requirements for both PSERS and SERS by imposing limits, referred to as "collars" on the rate at which employer contributions may rise from year-to-year. For the fiscal year beginning July 1, 2010, the total employer contribution rate for each System, referred to in the bill as the "final contribution rate," would be equivalent to 5.0% of the total compensation of all active members, plus in the case of PSERS, the premium assistance contribution rate, and in the case of SERS, the benefit completion plan contribution rate. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, the bill would establish temporary collared contribution rates, equal to 3%, 3.5% and 4.5%, for each year respectively. The collars would apply only if the calculation of the employer contribution rate results in an actuarially required contribution rate that is greater than the collared rate. The effect would be to limit the year-to-year increase in the employer contribution rate by the percentage amounts specified for each year. Beginning with the July 1, 2013, fiscal year, and for each year thereafter, the bill would limit the annual increase in employer contributions to no more than 4.5%, until such time as the actuarially required contribution rate calculated by the Systems' actuaries results in an increase in the employer rate that is less than the collared rate of 4.5%. At this point, the collared contribution limits would expire and a new employer contribution floor rate equal to each System's employer normal cost rate would be established.

As described previously, the fiscal challenges facing employers and the Commonwealth resulting from the much publicized pension "rate spike" are significant. However, it should be noted that the employer contribution collars proposed in the bill represent a departure from the norms of actuarial funding practice. The effect of the bill would be to suppress the employer contributions to both PSERS and SERS resulting in significant underfunding of both retirement systems. In turn, this underfunding will permit the continued growth of the Systems' unfunded liabilities resulting in a steady decline in the funded ratios of both PSERS and SERS.

Establishment of Employer Normal Cost Rate as Minimum Employer Contribution Floor

Act 38 of 2002 first established a 1% minimum employer contribution rate for both PSERS and SERS. In 2003, the mandated rate was increased through the enactment of Act 40 of 2003 for both Systems. For PSERS, the minimum employer contribution rate was increased effective July 1, 2004, from 1% to 4% plus the premium assistance contribution rate. For SERS, the rate was increased from 1% to: 1) 2% beginning July 1, 2004; 2) 3% beginning July 1, 2005; and 3) 4% beginning July 1, 2006. Act 8 of 2007 extended and made permanent the 4% employer floor rate for SERS.

The bill would establish the employer normal cost rate as the new employer contribution floor rate for all future years following expiration of the temporary collared contribution rates. By mandating payment of the employer normal contribution rate as the minimum or floor rate for all future years following expiration of the collared contribution rate, the bill would ensure that employer contributions in future years will be adequate to fund the costs of benefits earned in that year. The bill would not impact the cost of benefits already earned (accrued liability), nor would it directly affect the unfunded liabilities of the Systems.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill and the actuarial cost estimates provided to the Commission by the consulting actuaries for both PSERS and SERS and found these estimates to be reasonable. The result of these analyses is summarized in the following three tables. Table I shows the employer contribution rate and the employer contribution amount for PSERS for Fiscal Year 2011 to Fiscal Year 2042 under current law and under the bill. Table II shows the same information for SERS. Table III shows a comparison of the expected funded ratio using the actuarial value of assets for 2009 to 2040 for both PSERS and SERS under current law and under the bill. As shown in Tables I and II, the anticipated spike in the employer contribution rate in 2013 under current law would be delayed if the bill is enacted. For both Systems, the actuarially required contribution rate would be reached in 2016 and the collared contribution rates would then expire. The estimates show that the employer contribution rate for PSERS increases to 23% by 2016 and then gradually increases to approximately 29% beginning in 2029 through 2041 before decreasing to 18.9% in 2042. The employer contribution rate for SERS increases to about 25% beginning in 2016 through 2040 before decreasing to 19.6% in the year 2041. It should also be noted that the gradual increase in the employer contribution rate for PSERS is due to the appropriation payroll increasing at less than the assumed payroll growth of 4.0% per year. The projected appropriation payroll for SERS increases at the assumed payroll growth of 3.3% per year.

Table I

Public School Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042

($ amounts in millions)

		Current Law		House Bill 2497		Increase / (Decrease)	
Fiscal Year Ending June 30	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Employer Contribution Rate	Employer Contribution Amount	Employer Contribution Rate	Employer Contribution Amount
2011	$13,510.0	8.22%	$1,110.5	5.64%	$762.0	-2.58%	$(348.5)
2012	13,920.9	10.59%	1,474.2	8.72%	1,213.9	-1.87%	(260.3)
2013	14,345.3	29.22%	4,191.7	12.22%	1,753.0	-17.00%	(2,438.7)
2014	14,797.7	32.09%	4,748.6	16.71%	2,472.7	-15.38%	(2,275.9)
2015	15,280.1	33.60%	5,134.1	21.20%	3,239.4	-12.40%	(1,894.7)
2016	15,794.5	33.27%	5,254.8	23.31%	3,681.7	-9.96%	(1,573.1)
2017	16,341.3	32.74%	5,350.1	24.32%	3,974.2	-8.42%	(1,375.9)
2018	16,926.7	32.06%	5,426.7	25.29%	4,280.8	-6.77%	(1,145.9)
2019	17,557.7	31.27%	5,490.3	26.36%	4,628.2	-4.91%	(862.1)
2020	18,232.1	30.42%	5,546.2	27.25%	4,968.2	-3.17%	(578.0)
2021	18,948.0	29.56%	5,601.0	27.53%	5,216.4	-2.03%	(384.6)
2022	19,703.2	28.75%	5,664.7	27.77%	5,471.6	-0.98%	(193.1)
2023	20,493.7	27.95%	5,728.0	27.96%	5,730.0	0.01%	2.0
2024	21,321.5	27.18%	5,795.2	28.12%	5,995.6	0.94%	200.4
2025	22,185.0	26.44%	5,865.7	28.24%	6,265.0	1.80%	399.3
2026	23,081.8	25.74%	5,941.3	28.34%	6,541.4	2.60%	600.1
2027	24,006.8	25.05%	6,013.7	28.40%	6,817.9	3.35%	804.2
2028	24,958.6	24.40%	6,089.9	28.46%	7,103.2	4.06%	1,013.3
2029	25,937.5	23.78%	6,167.9	28.51%	7,394.8	4.73%	1,226.9
2030	26,944.0	23.19%	6,248.3	28.55%	7,692.5	5.36%	1,444.2
2031	27,978.1	22.63%	6,331.4	28.60%	8,001.7	5.97%	1,670.3
2032	29,041.5	22.10%	6,418.2	28.65%	8,320.4	6.55%	1,902.2
2033	30,136.5	19.46%	5,864.6	28.70%	8,649.2	9.24%	2,784.6
2034	31,268.4	18.16%	5,678.3	28.75%	8,989.7	10.59%	3,311.4
2035	32,446.3	16.82%	5,457.5	28.79%	9,341.3	11.97%	3,883.8
2036	33,675.8	15.65%	5,270.3	28.81%	9,702.0	13.16%	4,431.7
2037	34,956.6	14.33%	5,009.3	28.85%	10,085.0	14.52%	5,075.7
2038	36,292.1	13.88%	5,037.3	28.88%	10,481.2	15.00%	5,443.9
2039	37,690.6	14.64%	5,517.9	28.89%	10,888.8	14.25%	5,370.9
2040	39,153.0	14.47%	5,665.4	28.91%	11,319.1	14.44%	5,653.7
2041	40,680.0	13.15%	5,349.4	28.91%	11,760.6	15.76%	6,411.2
2042	42,266.6	12.18%	5,148.1	18.87%	7,975.7	6.69%	2,827.6
Total:			$169,590.6		$210,717.2		$41,126.6

Table II

State Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042
($ amounts in millions)

Fiscal Year Ending	Appropriation	Current Law		House Bill 2497		Increase / (Decrease)	
		Employer Contribution		Employer Contribution		Employer Contribution	
June 30	Payroll	Rate	Amount	Rate	Amount	Rate	Amount
2011	$5,936.0	5.64%	$335.0	5.00%	$296.8	-0.64%	$(38.2)
2012	6,131.9	7.98%	489.0	8.00%	490.6	0.02%	1.6
2013	6,334.2	26.66%	1,688.4	11.50%	728.4	-15.16%	(960.0)
2014	6,543.3	29.22%	1,911.7	16.00%	1,046.9	-13.22%	(864.8)
2015	6,759.2	27.72%	1,873.5	20.50%	1,385.6	-7.22%	(487.9)
2016	6,982.2	27.46%	1,917.0	24.53%	1,712.9	-2.93%	(204.1)
2017	7,212.7	27.09%	1,953.9	24.79%	1,788.1	-2.30%	(165.8)
2018	7,450.7	26.64%	1,985.2	24.87%	1,853.3	-1.77%	(131.9)
2019	7,696.5	26.16%	2,013.4	24.92%	1,917.9	-1.24%	(95.5)
2020	7,950.5	25.69%	2,042.1	24.96%	1,984.4	-0.73%	(57.7)
2021	8,212.9	25.22%	2,071.2	24.99%	2,052.8	-0.23%	(18.4)
2022	8,483.9	24.76%	2,100.9	25.03%	2,123.3	0.27%	22.4
2023	8,763.9	24.32%	2,131.5	25.06%	2,196.2	0.74%	64.7
2024	9,053.1	23.89%	2,163.0	25.09%	2,271.5	1.20%	108.5
2025	9,351.8	23.48%	2,195.5	25.12%	2,349.4	1.64%	153.9
2026	9,660.5	23.07%	2,229.1	25.15%	2,430.0	2.08%	200.9
2027	9,979.3	22.69%	2,263.9	25.18%	2,513.3	2.49%	249.4
2028	10,308.6	22.31%	2,299.7	25.22%	2,599.4	2.91%	299.7
2029	10,648.8	21.94%	2,336.7	25.25%	2,688.5	3.31%	351.8
2030	11,000.2	21.59%	2,375.0	25.28%	2,780.6	3.69%	405.6
2031	11,363.2	21.25%	2,414.5	25.31%	2,875.9	4.06%	461.4
2032	11,738.2	20.92%	2,455.3	25.34%	2,974.5	4.42%	519.2
2033	12,125.5	18.83%	2,283.7	25.37%	3,076.4	6.54%	792.7
2034	12,525.7	17.83%	2,233.3	25.40%	3,181.8	7.57%	948.5
2035	12,939.0	17.37%	2,247.8	25.43%	3,290.8	8.06%	1,043.0
2036	13,366.0	15.87%	2,121.2	25.46%	3,403.6	9.59%	1,282.4
2037	13,807.1	15.39%	2,125.1	25.50%	3,520.2	10.11%	1,395.1
2038	14,262.7	15.46%	2,205.1	25.53%	3,640.8	10.07%	1,435.7
2039	14,733.4	16.43%	2,420.5	25.56%	3,765.5	9.13%	1,345.0
2040	15,219.6	14.92%	2,270.8	25.59%	3,894.5	10.67%	1,623.7
2041	15,721.8	14.14%	2,223.0	19.61%	3,083.1	5.47%	860.1
2042	16,240.6	13.21%	2,144.7	17.73%	2,879.0	4.52%	734.3
Total:			$65,520.7		$76,796.0		$11,275.3

Table III

Projected Impact on PSERS and SERS Funded Ratios

	PSERS' Funded Ratio			SERS' Funded Ratio		
Valuation Year	Current Law	House Bill 2497	Increase/ (Decrease)	Current Law	House Bill 2497	Increase/ (Decrease)
2009	79.2%	79.2%	0.0%	84.4%	84.4%	0.0%
2010	73.4%	73.9%	0.5%	79.0%	79.7%	0.7%
2011	66.8%	69.9%	3.1%	72.3%	73.4%	1.1%
2012	58.3%	66.2%	7.9%	66.4%	66.1%	-0.3%
2013	54.2%	62.8%	8.6%	68.0%	65.8%	-2.2%
2014	55.1%	60.0%	4.9%	68.8%	65.3%	-3.5%
2015	56.7%	57.8%	1.1%	69.8%	65.4%	-4.4%
2016	58.5%	55.7%	-2.8%	70.9%	65.8%	-5.1%
2017	60.5%	53.5%	-7.0%	72.0%	66.3%	-5.7%
2018	62.6%	51.8%	-10.8%	73.2%	66.9%	-6.3%
2019	64.7%	51.9%	-12.8%	74.3%	67.5%	-6.8%
2020	66.8%	52.2%	-14.6%	75.5%	68.1%	-7.4%
2021	68.9%	52.8%	-16.1%	76.6%	68.8%	-7.8%
2022	71.0%	53.6%	-17.4%	77.8%	69.5%	-8.3%
2023	73.0%	54.6%	-18.4%	79.0%	70.4%	-8.6%
2024	75.0%	55.8%	-19.2%	80.2%	71.2%	-9.0%
2025	77.0%	57.1%	-19.9%	81.4%	72.2%	-9.2%
2026	79.0%	58.6%	-20.4%	82.7%	73.3%	-9.4%
2027	80.9%	60.2%	-20.7%	84.0%	74.4%	-9.6%
2028	82.8%	61.9%	-20.9%	85.3%	75.6%	-9.7%
2029	84.6%	63.7%	-20.9%	86.6%	76.9%	-9.7%
2030	86.5%	65.6%	-20.9%	88.0%	78.2%	-9.8%
2031	88.2%	67.5%	-20.7%	89.5%	79.7%	-9.8%
2032	90.0%	69.6%	-20.4%	90.6%	81.3%	-9.3%
2033	91.4%	71.7%	-19.7%	91.6%	82.9%	-8.7%
2034	92.7%	73.9%	-18.8%	92.6%	84.7%	-7.9%
2035	93.8%	76.2%	-17.6%	93.4%	86.5%	-6.9%
2036	94.7%	78.6%	-16.1%	94.1%	88.5%	-5.6%
2037	95.5%	81.0%	-14.5%	94.9%	90.5%	-4.4%
2038	96.2%	83.6%	-12.6%	95.9%	92.7%	-3.2%
2039	97.1%	86.3%	-10.8%	96.7%	94.9%	-1.8%
2040	97.9%	89.0%	-8.9%	97.4%	96.3%	-1.1%

POLICY CONSIDERATIONS

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

Appropriateness of Departure from Actuarial Funding Standards. The bill would reduce the actuarially required contribution rate to both PSERS and SERS for several years, effectively delaying the anticipated spike in employer contribution rates projected to begin in 2013. The Commission is well aware of the fiscal challenges facing the Commonwealth resulting from the anticipated pension contribution spike. However, it must be noted that the temporary collared contribution rates proposed in the bill do not follow generally accepted actuarial standards of practice. The short-term effect of the bill would be to defer the payment of actuarially required contributions to both PSERS and SERS, resulting in the underfunding of both retirement systems. This underfunding will permit the continued growth of the Systems' unfunded liabilities resulting in a steady decline in the funded ratios of both PSERS and SERS. The bill appears to be intended to delay the anticipated contribution increases, spread those increases over many future years, but to determine contribution rates in an actuarially sound manner in the long term. The Commonwealth's policymakers must determine whether the temporary departure from actuarial funding proposed by the bill is consistent with the Commonwealth's pension plan funding and fiscal management goals.

Re-amortization of Pension Liabilities. The bill would require PSERS and SERS to re-amortize all of the unfunded actuarial accrued liabilities of their pension trust funds over a 30-year period. The re-amortization of pension plan liabilities is a legitimate actuarial technique. Under the level percentage of pay amortization method proposed in the bill, the unfunded accrued liability of both PSERS and SERS is expected to increase for the first 18 to 20 years, because the amortization payments will be insufficient to pay the interest accruing on the outstanding balance of the unfunded liabilities of the Systems. Contributions in the later years of the amortization period will therefore be much higher to compensate for the years that payments made were less than the interest on the outstanding balance. Therefore, the fresh start re-amortization of liabilities combined with the use of level percent of pay amortization payments will have the advantage of reducing annual employer contribution requirements in the short term, but long term will result in much higher contributions in later years and ultimately in greater total costs to the Commonwealth and other employers.

Extended Smoothing Period. For PSERS, the bill would extend from five years to ten years the smoothing period applicable to the investment gains and losses of the System. The Actuarial Standards Board (ASB) is an entity within the American Academy of Actuaries (AAA) that establishes standards of practice for the actuarial profession in the United States. Actuarial Standards of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, requires that asset smoothing methods must recognize "*the differences from the market value of assets in a sufficiently short period*." It is the professional opinion of the Commission's consulting actuary that ten years is too long a time period over which to recognize investment gains and losses because such an extended smoothing period has the potential to produce actuarial values of assets that deviate greatly from market values of assets. While the extended smoothing period would have the advantage of delaying the recognition of unfavorable investment experience, it would also have the consequence of delaying recognition of favorable investment experience in future years. In the short-term, the extended smoothing period would serve to mitigate the negative effects of the unprecedented investment losses suffered by PSERS in 2008 by extending the period over which those investment losses are recognized.

New Employer Contribution Floor. The bill would establish the employer normal cost rate as the new employer contribution floor rate for all future years following expiration of the temporary collared contribution rates. Normal cost equates to the value or "cost" of benefits accrued by active members in a given year. By mandating payment of the employer portion of the normal cost rate as the minimum contribution rate for all future years following expiration of the collared contribution rate, the bill would ensure that employer contributions in future years will be adequate to fund the costs of benefits earned in that year. The bill would not impact the cost of benefits already earned (accrued liability), nor would it affect the unfunded liabilities of the Systems.

POLICY CONSIDERATIONS (CONT'D)

Technical Drafting Consideration. The bill would amend Section 5508(f)(1) of the SERS Code, pertaining to the "experience adjustment factor," to state that one of the permissible causes for an increase or decrease in the unfunded accrued liability of the System may be *"changes in contributions caused by the final contribution rate being different from the actuarially required contribution rate."* The bill does not make a corresponding amendment relating to the experience adjustment factor in the PSERS Code. The bill sponsor may wish to consider an amendment to Section 8328(e)(1) of the PSERS Code to provide specificity similar to that for the SERS Code.

COMMISSION RECOMMENDATIONS

On May 27, 2010, 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

A later version of House Bill Number 2497 was signed into law by the Governor on November 23, 2010.

Bill ID: House Bill Number 2497, Printer's Number 3853, as amended by Amendment Number 07493

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

Subject: New Benefit Tiers and Modifications to Actuarial Funding Requirements

SYNOPSIS

House Bill Number 2497, Printer's Number 3853, as amended by Amendment Number 07493, would amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) to mandate the establishment of new benefit tiers applicable to most new members of both the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS), and modify the actuarial funding requirements of both PSERS and SERS.

The bill as amended would amend the Public School Employees' Retirement Code to:

1) Establish a new class of membership, known as "Class T-E." Any employee who becomes a member of the system after June 30, 2011, would become a member of Class T-E unless the member elects to become a member of the new optional membership class, known as "Class T-F." A Class T-E member would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement equal to 7.5% of compensation.

2) Establish an optional new class of membership, known as "Class T-F." Any employee who becomes a member of the system after June 30, 2011, would have the option of electing Class T-F membership within 45 days of becoming a member of the system. A Class T-F member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 10.3% of compensation.

3) Beginning July 1, 2011, re-amortize all of the unfunded actuarial accrued liabilities of PSERS over a 30-year period using level percentage of pay amortization payments;

4) Beginning July 1, 2011, extend from five years to ten years the asset smoothing period over which the fund's investment gains and losses are recognized;

5) Fund any increases in accrued liability enacted by legislation, other than the bill, subsequent to June 30, 2010, over a 10-year period using level percentage of pay amortization payments; the cost of this legislation will be amortized over 30 years;

6) For the fiscal year beginning July 1, 2010, establish the total employer contribution rate as the "final contribution rate" of between 5.0% and 7.58% of the total compensation for all active members, plus the premium assistance contribution rate;

7) Modify employer contribution requirements to PSERS by imposing limits, referred to as "collars" on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total compensation of all active members

greater than the prior year's final contribution rate, then the collared contribution rate shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total compensation for all active members; and

8) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate.

The bill as amended would amend the State Employees' Retirement Code to:

1) Establish a new class of membership applicable to most new members (including members of the General Assembly), known as "Class A-3," requiring all new members of the system, other than a member employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, to become a member of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010), including an employee who is not an active member of the system (because membership is optional or prohibited), but who becomes a member of the system on or after January 1, 2011, unless the member elects to become a member of the optional membership class known as "Class A-4." Class A-3 members would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement of 6.25% of compensation.

2) Establish an optional new class of membership, known as "Class A-4." An employee who becomes a member of the system on or after January 1, 2011, would have the option of electing Class A-4 membership within 45 days of becoming a member of the system. A Class A-4 member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 9.3% of compensation.

3) Beginning July 1, 2010, re-amortize all of the unfunded actuarial accrued liabilities of SERS, including previously enacted supplemental annuities, over a 30-year period using level percentage of pay amortization payments;

4) Maintain the current five-year smoothing period over which investment gains and losses are recognized;

5) Fund any increase in accrued liability enacted by legislation, other than this bill, subsequent to December 31, 2009, over a 10-year period using level percentage of pay amortization payments; the cost of this legislation will be amortized over 30 years;

6) For the fiscal year beginning July 1, 2010, establish the total employer contribution rate as the "final contribution rate" of 5.0% of the total compensation for all active members;

7) Modify employer contribution requirements to SERS by imposing limits, referred to as "collars," on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total compensation of all active members greater than the prior year's final contribution rate, then the collared contribution rate

shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total compensation for all active members; and

8) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate.

DISCUSSION

The Retirement Codes and Systems

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer pension plans. The designated purpose of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS) is to provide retirement allowances and other benefits, including disability and death benefits to public school and state employees. As of June 30, 2009, there were approximately 754 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS, and approximately 107 Commonwealth and other employers participating in SERS.

Membership in PSERS and SERS 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, 2009, there were 279,701 active members and 177,963 annuitant members of PSERS, and as of December 31, 2009, there were 110,107 active members and 109,639 annuitant members of SERS.

For most members of both Systems, the basic benefit formula used to determine the normal retirement benefit is equivalent to the product of 2.5% multiplied by the member's years of accumulated service credit ("eligibility points") multiplied by the member's final average (highest three years) salary. Since the passage of Act 9 of 2001 (which increased the accrual rate for most members from 2.0% to 2.5%), most members of PSERS are Class T-D members and contribute 7.5% of pay to the System, while most members of SERS are Class AA members and contribute 6.25% of pay to the System. Within both Systems, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school and state employees.[1]

Under the Codes of both Systems, superannuation or normal retirement age is that date on which a member may terminate service with the public employer and receive a full retirement benefit without reduction. 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 at least 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.

[1] Both PSERS and SERS utilize a number of "membership classes," each with its corresponding "class of service multiplier" that is multiplied by a base accrual rate to determine the member's benefit, rather than a simple accrual rate applied to all members. The exception is PSERS membership Class T-D, for which the accrual rate is specified as 2.5% annually. (See PSERS Code Section 8102, definition of "Standard Single Life Annuity" and "Class of Service Multiplier." See SERS Code Section 5102, definition of "Class of Service Multiplier.")

Prior to the passage of Act 9 of 2001, the annual benefit accrual rate applicable to most members of PSERS and SERS was 2.0%. Act 9, through the creation of several new classes of membership in the Systems (Class T-D in PSERS; Class AA and Class D-4 in SERS), effectively increased the benefit accrual rates for most PSERS and SERS members from 2.0% to 2.5% (for members of the General Assembly who elected membership in Class D-4, the annual benefit accrual rate increased to 3.0%). Because Act 9 was applicable to all periods of school and State service, both retrospective and prospective, the effect of the increased benefit accruals was to enhance the value of most members' retirement benefits by 25% (50% for D-4 members of the General Assembly).

New Benefit Tiers

House Bill Number 2497, Printer's Number 3853, as amended by Amendment Number 07493, would mandate the establishment of new benefit tiers applicable to new members of both Systems through the creation of additional membership classes. The bill as amended would amend each retirement Code in the following manner:

1) The Public School Employees' Retirement Code, effective July 1, 2011, to create two new classes of membership for school employees, known as "Class T-E," and "Class T-F." New members of the system would become members of Class T-E beginning July 1, 2011. Class T-E members would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement of 7.5% of compensation. Additionally, the bill as amended would create an optional new class of membership, known as "Class T-F." Any employee who becomes a member of the System after June 30, 2011, would have the option of electing Class T-F membership within 45 days of becoming a member of the system. A Class T-F member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 10.3% of compensation. A member who fails to elect Class T-F within 45 days of becoming a member of the System would automatically become a member of Class T-E. Current Class T-D members of the system who have a future break in service would remain members of Class T-D upon their return.

2) The bill as amended would amend the State Employees' Retirement Code, effective January 1, 2011, to create two new classes of membership for State employees (including members of the General Assembly), known as "Class A-3," and "Class A-4." Most new members of the System, other than a State Police officer or a member employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, would become members of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010), including an employee who is not an active member of the system (because membership is optional or prohibited), but who becomes a member of the system on or after January 1, 2011. Class A-3 members would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement of 6.25% of compensation. Additionally, the bill as amended would create an optional new class of membership, known as "Class A-4." An employee who becomes a member of the system on or after January 1, 2011, would have the option of electing Class A-4 membership within 45 days of becoming a member of the system. A Class A-4 member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 9.3% of compensation. A member who fails to elect Class A-4 within 45 days of becoming a member of the System would automatically become a member of Class A-3. Current Class AA members of the system who have a future break in service would remain members of Class AA upon their return.

The bill as amended would amend the Codes of both PSERS and SERS to:

1) Increase the vesting requirements for most new members from 5 years to 10 years.

2) Increase the superannuation requirements to age 65 with a minimum of three years of service credit, or any age with 35 years of service. In the case of PSERS members, the option of superannuating at age 60 with 30 years of service would be eliminated for new members. Members of the General Assembly who become members of Class A-3 or A-4 on or after December 1, 2010, would become eligible for a superannuation annuity at age 55. For all other members (including State police officers) who currently superannuate at age 50, superannuation for Class A-3 and Class A-4 members would increase to age 55. For park rangers and Capitol police officers who currently superannuate at age 50 with 20 years of park ranger or Capitol police officer service, superannuation would increase to age 55 with 20 years of park ranger or Capitol police officer service.

3) Restrict new members from waiving their member contributions if the Maximum Single Life Annuity benefit is greater than or equal to 110% of the member's highest year salary.

4) Eliminate members' eligibility to withdraw their accumulated deductions in a lump sum at retirement under retirement Option 4.

Both current and new members of the judiciary will be unaffected by the benefit changes. Officers of the Pennsylvania State Police who become members of SERS on or after January 1, 2011, would receive Class A-3 service credit and benefits until they become eligible for the enhanced State Trooper retirement benefits upon attaining 20 years of credited service. A current Class D-4 member of the General Assembly who leaves service and later returns to the General Assembly will retain Class D-4 membership.

The bill as amended would not affect the retirement benefit rights of current active members of the Systems. Instead, the bill as amended seeks to create new benefit tiers within PSERS and SERS applicable only to employees who become members of PSERS and SERS on or after July 1, 2011, in the case of PSERS and January 1, 2011, in the case of SERS.

In Pennsylvania, public employee retirement benefits are recognized as deferred compensation for work already performed, which confers upon public employees certain contractual rights protected by the Pennsylvania Constitution (Article I Section 17).[2] *Police Officers of Hatboro v. Borough of Hatboro,* 559 A.2d 113 (Pa. Cmwlth 1989); *McKenna v. State Employees' Retirement Board,* 495 Pa. 324, 433 A.2d 871 (1981); *Catania v. State Employees' Retirement Board,* 498 Pa. 684, 450 A.2d (1982). These contractual pension rights become fixed upon the employee's entry into the retirement system and cannot be subsequently unilaterally diminished or adversely affected, regardless of whether (1) the member is vested; or (2) the devaluation is necessary for actuarial soundness. *Association of Pa. State College and University Faculties v. State System of Higher Education,* 505 Pa. 369, 479 A.2d 962 (1984). See also *Hughes v. Public School Employees' Retirement Board*, 662 A.2d 701 (Pa. Cmwlth. 1995), *alloc. denied,* 542 Pa. 678, 668 A.2d 1139 (1995) (member has property interest in pension benefit).

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[2] The Pa. Constitution provides: "No ex post facto law, nor any law impairing the obligations of contract, … shall be passed."

By creating new benefit tiers applicable only to school or State employees who become members of PSERS or SERS, the bill as amended avoids impairing the contractual retirement benefit rights of current members of the Systems, while having the effect of creating a new contractual relationship between the public employer and new members of the Systems.

Section 8328 of the PSERS Code and Section 5508 of the SERS Code specify similar methods to be used by the actuaries of the respective systems to determine the "employer normal contribution rate" or employer normal cost and the total employer contribution rate, which consists of both the normal cost and the contributions required to fund the accrued liabilities of each plan, plus any amortization contribution requirement.

Both the PSERS and SERS Codes require the normal cost to be determined using "... a level percentage of the compensation of the average new active member...." However, the Systems apply different interpretations to the language. Using the SERS interpretation, the average new member, or entrant, to the Systems currently earns a benefit at the 2.5% annual accrual rate. However, if enacted, the bill would require new entrants to the Systems to earn benefits at a reduced 2.0% accrual rate. This would result in a diminished normal cost calculation that would tend to understate the true cost of SERS, because in the early years of the reduced benefit tier, the majority of members would remain in a benefit class entitling them to an annual benefit accrual of 2.5%. In the short term, the understated normal cost could generate an unfunded actuarial accrued liability in SERS. This would occur because reducing the benefit accrual rate for new members only would not affect the present value of benefits for current members, but would affect the normal cost calculation.

The traditional method would be to develop the normal cost rate based upon current active members and the benefits to which each member is entitled. This method would be based upon a blending of accrual rates attributable to all active members, rather than new entrants only, and would result in a normal cost calculation that more closely approximates the normal costs of the Systems. The traditional method would also help to achieve the presumed cost reduction goals of the bill by both reducing the normal cost of the Systems and preventing the creation of the unfunded actuarial accrued liabilities that would otherwise result from enactment of the bill. According to the Commission's consulting actuary, PSERS is currently using the traditional normal cost method.

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.

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. A member may elect to receive this withdrawal in one lump sum or in up to four installment payments. The installments 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.

Under the bill as amended, the election to withdraw the member's accumulated deductions under Option 4 would be eliminated as an option for new members of PSERS and SERS who otherwise would be eligible to receive retirement benefits. Members of Class T-E , T-F, A-3 and A-4 who terminate service before vesting would continue to be entitled to withdraw their accumulated deductions plus the interest earned on those contributions upon termination of service, in lieu of any claim to other benefits.

Unfunded Liabilities and Amortization Periods

Generally, the overall funding objective of a public employee pension plan is to provide reserves sufficient to fund the benefits of plan members when those benefits become due and to fund, over time, any unfunded liability through installment payments. As the funded ratio (ratio of assets to liabilities) of a pension plan declines below 100%, the plan's assets represent an increasingly smaller portion of the system's accrued liabilities. A pension trust fund in which the value of the actuarial accrued liabilities exceeds the actuarial value of assets is said to have an unfunded actuarial accrued liability. This funding shortfall may occur for many reasons, including benefit liberalizations, unfavorable investment or other actuarial experience, changes in major economic or demographic assumptions, or underfunding of the system by the employer. Based upon the June 30, 2009, actuarial valuation for PSERS, the retirement system reported unfunded actuarial accrued liabilities totaling $15.7 billion, representing a funded ratio of 79.2%. Based upon the December 31, 2009, actuarial valuation for SERS, the retirement system reported unfunded actuarial accrued liabilities totaling $5.6 billion, representing a funded ratio of 84.4%.

The unfunded actuarial accrued liability existing in a pension trust fund must be amortized over time through installment payments. Under the Codes of both Systems, the permissible amortization periods are either 10 years or 30 years, depending upon the source of the liability. Subsequent to the passage of Act 40 of 2003, the amortization period for: 1) the increased liabilities of Act 9 of 2001; 2) the outstanding balances of the net actuarial losses incurred by PSERS in fiscal years 2000-01 and 2001-02 and by SERS in calendar year 2002; and 3) the gains and losses experienced in all future years is 30 years rather than 10 years, with the amortization contributions calculated as level-dollar payments. Amortization of the remaining balance of the pre-Act 9 of 2001 unfunded actuarial accrued liability, the future unfunded actuarial accrued liabilities attributable to benefit changes, including supplemental annuities, and in the case of PSERS, the gains and losses attributable to the change in the asset valuation methodology under Act 38 of 2002 continue to be amortized over 10 years on a level-dollar basis.

Based on current projections, the Commonwealth will experience large increases in employer contributions beginning in fiscal year 2012-2013, when the unfunded liability portion of the employer contribution rate begins to sharply increase. This employer contribution "rate spike" is the result of large unfunded liabilities generated by four major factors: 1) the two major market down turns during the past decade, from roughly 2001-2003 and again in 2008; 2) the benefit enhancement provided to active members of both PSERS and SERS by the passage of Act 9 of 2001; 3) the additional unfunded liability resulting from the two-tier cost-of-living adjustment provided to retired PSERS and SERS members by Act 38 of 2002; and 4) changes to funding methods resulting from the enactment of Act 38 of 2002 and Act 40 of 2003. Combined, Acts 38 and 40 had the effect of deferring the funding of liability. Of the two, Act 40 had the greatest impact by requiring PSERS and SERS to amortize certain gains and losses over different periods of time. Under Act 40, the recognition of pre-Act 9 gains was accelerated by amortizing these gains over a 10-year period, while the recognition of post-Act 9 losses was delayed by amortizing these losses over 30 years. The result was, in effect, a mismatch of the amortization of gains and losses, generating a 10-year credit that has suppressed the employer contribution rate and masked the true costs of the Systems. This 10-year credit will be fully amortized by fiscal year 2012-2013, which, not coincidentally, corresponds with the first year of the projected contribution rate spike.

The bill as amended would restructure the amortization periods of both PSERS and SERS for the fiscal years beginning July 1, 2011, and July 1, 2010, respectively. The bill as amended would require the Systems to re-amortize all of the unfunded actuarial accrued liabilities of their pension trust funds over a 30-year period. This "fresh start" of the amortization bases would have the effect of extending the amortization of the Systems' current pension liabilities, resulting in a reduction in the Systems' annual amortization contribution requirements.

The bill as amended would also require the use of a level-percentage of pay amortization method, rather than the level-dollar method currently used by both PSERS and SERS. Compared to the level-dollar amortization method, which results in level installment payments throughout the course of the amortization period, the level-percentage of pay method will produce amortization payments that are generally lower than would be the case under the level-dollar method in the early years of the amortization period, but steadily rise by a level percentage of pay using each System's assumed annual payroll increase assumption (4.0% for PSERS and 3.3% for SERS). Although the level-percentage of pay amortization method has the advantage of helping reduce annual employer contribution requirements in the early years, this method will result in steadily escalating contribution requirements and ultimately greater total costs.

Additionally, increases in accrued liability caused by legislation enacted subsequent to June 30, 2010, for PSERS, and subsequent to December 31, 2009, for SERS, would continue to be amortized over a 10-year period, but would use level percentage of pay amortization payments instead of level-dollar payments as currently required by the Codes of both Systems. The accrued liability arising from the implementation of the bill would be amortized over 30 years.

Asset Smoothing

In public pension systems, asset "smoothing" involves the gradual recognition of investment gains and losses over time and is part of the method used to determine the actuarial value of assets in a pension trust fund. One purpose of the various smoothing methods is to avoid large year-to-year fluctuations in employer contribution requirements that may otherwise result from volatility in the investment markets.

Both PSERS and SERS currently apply a 5-year smoothing period to recognize investment gains and losses. The bill as amended would preserve the 5-year smoothing period for SERS, but for PSERS, the bill as amended would extend from 5 years to 10 years the smoothing period applicable to investment gains and losses. The Actuarial Standards Board (ASB) is an entity within the American Academy of Actuaries (AAA) that establishes standards of practice for the actuarial profession in the United States. Actuarial Standards of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, requires that asset smoothing methods must recognize "*the differences from the market value of assets in a sufficiently short period.*" It is the professional opinion of the Commission's consulting actuary that ten years is too long a time period over which to recognize investment gains and losses because such an extended smoothing period has the potential to produce actuarial values of assets that deviate greatly from market values of assets. While the extended smoothing period would have the effect of delaying the recognition of unfavorable investment experience, it would also have the consequence of delaying recognition of favorable investment experience in future years. In the short-term, the extended smoothing period would serve to mitigate the negative effects of the unprecedented investment losses suffered by PSERS in 2008 by extending the period over which those investment losses are recognized.

Modification of Employer Contribution Requirements

PSERS and SERS are funded through: 1) employer contributions, 2) employee contributions, and 3) returns on investments. The employer normal contribution rate represents the employer portion of the value or cost (normal cost) of the benefits earned during a given year, based upon the Systems' actuarial funding methods.

Like most large defined benefit public employee retirement systems throughout the United States, PSERS and SERS both utilize variations of the entry age normal actuarial cost method. The entry age normal cost method allocates the annual cost of all future benefits to be paid by the plan by spreading those costs over the entire period of a member's service from the date of entry to the member's anticipated date of retirement. These costs are expressed both as a dollar amount and as a percentage of actual or projected payroll. This method results in the calculation of two costs: 1) the annual contributions required to establish sufficient reserves to support future retirement benefits when made from entry age to normal retirement age is the normal cost; and 2) the aggregate normal cost of all members of the plan for prior years of service is the actuarial accrued liability. If assets of the plan are less than the accrued liability, then a deficit exists. This deficit is known as an unfunded actuarial accrued liability. Because this liability has not been accounted for or funded, it must be amortized through annual payments over a specified number of years, and the required annual payments are reflected in the total determination of employer annual cost.

The employer contribution requirements for both PSERS and SERS are determined using the employer portion of the employer normal cost, plus any amortization contribution requirements necessary to amortize the unfunded liabilities of the System over the statutorily specified amortization time periods as modified by the experience adjustment factor. The experience adjustment factor is a reference to the experience of the pension funds, most importantly, the investment experience of those funds. If gains from positive plan experience are greater than expected, employer contributions may be reduced. Conversely, losses from negative plan experience require additional employer contributions to compensate for those losses.

House Bill Number 2497, Printer's Number 3853, as amended by Amendment Number 07493, would modify the methods currently used to determine the employer contribution requirements for both PSERS and SERS by imposing limits, referred to as "collars" on the rate at which employer contributions may rise from year-to-year. For the fiscal year beginning July 1, 2010, the total employer contribution rate for each System, referred to in the bill as the "final contribution rate," would be modified. In the case of PSERS, the modified contribution rate would be not less than 5.0% nor more than 7.58% of the total compensation of all active members, plus the premium assistance contribution rate. In the case of SERS, the contribution rate would be fixed at 5.0%, plus the benefit completion plan contribution rate. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, the bill as amended would establish temporary collared contribution rates, equal to 3%, 3.5% and 4.5%, for each year respectively. The collars would apply only if the calculation of the employer contribution rate results in an actuarially required contribution rate that is greater than the collared rate. The effect would be to limit the year-to-year increase in the employer contribution rate by the percentage amounts specified for each year. Beginning with the July 1, 2013, fiscal year, and for each year thereafter, the bill as amended would limit the annual increase in employer contributions to no more than 4.5%, until such time as the actuarially required contribution rate calculated by the Systems' actuaries results in an increase in the employer rate that is less than the collared rate of 4.5%. At this point, the collared contribution limits would expire and a new employer contribution floor rate equal to each System's employer normal cost rate would be established.

As described previously, the fiscal challenges facing employers and the Commonwealth resulting from the much publicized pension "rate spike" are significant. However, it should be noted that the employer contribution collars proposed in the bill represent a departure from the norms of actuarial funding practice. The effect of the bill as amended would be to suppress the employer contributions to both PSERS and SERS resulting in significant underfunding of both retirement systems. In turn, this underfunding will permit the continued growth of the Systems' unfunded liabilities resulting in a steady decline in the funded ratios of both PSERS and SERS.

Establishment of Employer Normal Cost Rate as Minimum Employer Contribution Floor

Act 38 of 2002 first established a 1% minimum employer contribution rate for both PSERS and SERS. In 2003, the mandated rate was increased through the enactment of Act 40 of 2003 for both Systems. For PSERS, the minimum employer contribution rate was increased effective July 1, 2004, from 1% to 4% plus the premium assistance contribution rate. For SERS, the rate was increased from 1% to: 1) 2% beginning July 1, 2004; 2) 3% beginning July 1, 2005; and 3) 4% beginning July 1, 2006. Act 8 of 2007 extended and made permanent the 4% employer floor rate for SERS.

The bill as amended would establish the employer normal cost rate as the new employer contribution floor rate for all future years following expiration of the temporary collared contribution rates. By mandating payment of the employer normal contribution rate as the minimum or floor rate for all future years following expiration of the collared contribution rate, the bill as amended would ensure that employer contributions in future years will be adequate to fund the costs of benefits earned in that year. The bill as amended would not impact the cost of benefits already earned (accrued liability), nor would it directly affect the unfunded liabilities of the Systems.

Miscellaneous Provisions

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. Act 9 of 2001 amended the Codes of both PSERS and SERS to expand the multiple service election period from 30 days to 365 days, requiring six changes to the existing statutes: three in the PSERS Code and three in the SERS Code. One of the changes to the SERS Code was inadvertently overlooked. The bill as amended would correct this technical oversight to make the language consistent with the clear intent of the General Assembly. In practice, SERS has been administering the multiple service provision based on a 365-day election period. The bill as amended also makes numerous changes to the Codes of both systems that are of a technical, administrative, or editorial nature.

With respect to the new benefit tiers established by the bill as amended, the Commission's consulting actuary has reviewed the bill and determined the actuarial cost impact based upon current statutory provisions of the PSERS and SERS Codes specifying the methods for calculating the employer normal contribution rate. For SERS, because the employer normal contribution calculation is based upon a level percentage of the compensation of the average new member, the resulting normal cost would tend to understate the employer normal cost. This is largely due to the fact that the majority of members in the early years would remain in the higher benefit accrual group (2.5%), while the normal cost calculation would be based upon the average new entrant who, under the bill, would receive a diminished annual benefit accrual (2.0%).

The Commission's consulting actuary has reviewed the bill as amended and the actuarial cost estimates provided to the Commission by the consulting actuaries for both PSERS and SERS The results of these analyses are summarized in the following four tables. Table I shows the employer contribution rate and the employer contribution amount for PSERS for Fiscal Year 2011 to Fiscal Year 2042 under current law and under the bill. Table II shows the same information for PSERS, but utilizing the system's currently certified employer contribution rate of 8.22%. Table III shows the applicable data for SERS. Table IV shows a comparison of the expected funded ratio using the actuarial value of assets for 2009 to 2040 for both PSERS and SERS under current law and under the bill. As shown in Tables I and II and III, the anticipated spike in the employer contribution rate in 2013 under current law would be delayed if the bill as amended is enacted. For both Systems, the actuarially required contribution rate would be reached in 2016 and the collared contribution rates would then expire.

TABLE I

Public School Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042

($ amounts in millions)

Fiscal Year Ending June 30	Current Law			House Bill 2497 as amended by Amendment No. 07493 with 5.64% employer contribution rate for FY 2011			Increase / (Decrease)	
	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Employer Contribution Rate	Employer Contribution Amount
2011	$13,510.0	8.22%	$1,110.5	$13,510.0	5.64%	$762.0	-2.58%	$(348.5)
2012	13,920.9	10.59%	1,474.2	13,920.9	8.72%	1,213.9	-1.87%	(260.3)
2013	14,345.3	29.22%	4,191.7	14,345.3	12.22%	1,753.0	-17.00%	(2,438.7)
2014	14,797.7	32.09%	4,748.6	14,791.5	16.71%	2,471.7	-15.38%	(2,276.9)
2015	15,280.1	33.60%	5,134.1	15,267.7	21.20%	3,236.8	-12.40%	(1,897.3)
2016	15,794.5	33.27%	5,254.8	15,777.4	22.71%	3,583.0	-10.56%	(1,671.8)
2017	16,341.3	32.74%	5,350.1	16,326.3	23.52%	3,839.9	-9.22%	(1,510.2)
2018	16,926.7	32.06%	5,426.7	16,904.7	24.34%	4,114.6	-7.72%	(1,312.1)
2019	17,557.7	31.27%	5,490.3	17,527.5	25.27%	4,429.2	-6.00%	(1,061.1)
2020	18,232.1	30.42%	5,546.2	18,194.0	26.02%	4,734.1	-4.40%	(812.1)
2021	18,948.0	29.56%	5,601.0	18,906.3	26.17%	4,947.8	-3.39%	(653.2)
2022	19,703.2	28.75%	5,664.7	19,659.3	26.29%	5,168.4	-2.46%	(496.3)
2023	20,493.7	27.95%	5,728.0	20,439.4	26.37%	5,389.9	-1.58%	(338.1)
2024	21,321.5	27.18%	5,795.2	21,258.3	26.41%	5,614.3	-0.77%	(180.9)
2025	22,185.0	26.44%	5,865.7	22,114.8	26.41%	5,840.5	-0.03%	(25.2)
2026	23,081.8	25.74%	5,941.3	23,005.9	26.39%	6,071.3	0.65%	130.0
2027	24,006.8	25.05%	6,013.7	23,925.3	26.33%	6,299.5	1.28%	285.8
2028	24,958.6	24.40%	6,089.9	24,865.0	26.27%	6,532.0	1.87%	442.1
2029	25,937.5	23.78%	6,167.9	25,831.3	26.21%	6,770.4	2.43%	602.5
2030	26,944.0	23.19%	6,248.3	26,826.4	26.13%	7,009.7	2.94%	761.4
2031	27,978.1	22.63%	6,331.4	27,849.4	26.06%	7,257.6	3.43%	926.2
2032	29,041.5	22.10%	6,418.2	28,901.9	25.98%	7,508.7	3.88%	1,090.5
2033	30,136.5	19.46%	5,864.6	29,977.9	25.91%	7,767.3	6.45%	1,902.7
2034	31,268.4	18.16%	5,678.3	31,090.7	25.84%	8,033.8	7.68%	2,355.5
2035	32,446.3	16.82%	5,457.5	32,250.6	25.75%	8,304.5	8.93%	2,847.0
2036	33,675.8	15.65%	5,270.3	33,463.7	25.67%	8,590.1	10.02%	3,319.8
2037	34,956.6	14.33%	5,009.3	34,728.3	25.59%	8,887.0	11.26%	3,877.7
2038	36,292.1	13.88%	5,037.3	36,038.3	25.51%	9,193.4	11.63%	4,156.1
2039	37,690.6	14.64%	5,517.9	37,412.0	25.42%	9,510.1	10.78%	3,992.2
2040	39,153.0	14.47%	5,665.4	38,851.7	25.33%	9,841.1	10.86%	4,175.7
2041	40,680.0	13.15%	5,349.4	40,358.6	25.22%	10,178.4	12.07%	4,829.0
2042	42,266.6	12.18%	5,148.1	41,923.9	15.00%	6,288.6	2.82%	1,140.5
Total:			$169,590.6			$191,142.6		$21,552.0

TABLE II

Public School Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042

($ amounts in millions)

Fiscal Year	House Bill 2497 as amended by Amendment 07493 with 5.64% employer contribution rate for FY 2011			House Bill 2497 as amended by Amendment 07493 with 8.22% employer contribution rate for FY 2011			Increase / (Decrease)	
Year Ending	Appropriation	Employer Contribution		Appropriation	Employer Contribution		Employer Contribution	
June 30	Payroll	Rate	Amount	Payroll	Rate	Amount	Rate	Amount
2011	$13,510.0	5.64%	$762.0	$13,510.0	8.22%	$1,110.5	2.58%	$348.5
2012	13,920.9	8.72%	1,213.9	13,920.9	8.72%	1,213.9	0.00%	0.0
2013	14,345.3	12.22%	1,753.0	14,345.3	12.22%	1,753.0	0.00%	0.0
2014	14,791.5	16.71%	2,471.7	14,791.5	16.71%	2,471.7	0.00%	0.0
2015	15,267.7	21.20%	3,236.8	15,267.7	21.20%	3,236.8	0.00%	0.0
2016	15,777.4	22.71%	3,583.0	15,777.4	22.53%	3,554.6	-0.18%	(28.4)
2017	16,326.3	23.52%	3,839.9	16,326.3	23.33%	3,808.9	-0.19%	(31.0)
2018	16,904.7	24.34%	4,114.6	16,904.7	24.15%	4,082.5	-0.19%	(32.1)
2019	17,527.5	25.27%	4,429.2	17,527.5	25.08%	4,395.9	-0.19%	(33.3)
2020	18,194.0	26.02%	4,734.1	18,194.0	25.83%	4,699.5	-0.19%	(34.6)
2021	18,906.3	26.17%	4,947.8	18,906.3	25.98%	4,911.9	-0.19%	(35.9)
2022	19,659.3	26.29%	5,168.4	19,659.3	26.10%	5,131.1	-0.19%	(37.3)
2023	20,439.4	26.37%	5,389.9	20,439.4	26.18%	5,351.0	-0.19%	(38.9)
2024	21,258.3	26.41%	5,614.3	21,258.3	26.22%	5,573.9	-0.19%	(40.4)
2025	22,114.8	26.41%	5,840.5	22,114.8	26.22%	5,798.5	-0.19%	(42.0)
2026	23,005.9	26.39%	6,071.3	23,005.9	26.20%	6,027.5	-0.19%	(43.8)
2027	23,925.3	26.33%	6,299.5	23,925.3	26.14%	6,254.1	-0.19%	(45.4)
2028	24,865.0	26.27%	6,532.0	24,865.0	26.08%	6,484.8	-0.19%	(47.2)
2029	25,831.3	26.21%	6,770.4	25,831.3	26.01%	6,718.7	-0.20%	(51.7)
2030	26,826.4	26.13%	7,009.7	26,826.4	25.94%	6,958.8	-0.19%	(50.9)
2031	27,849.4	26.06%	7,257.6	27,849.4	25.87%	7,204.6	-0.19%	(53.0)
2032	28,901.9	25.98%	7,508.7	28,901.9	25.79%	7,453.8	-0.19%	(54.9)
2033	29,977.9	25.91%	7,767.3	29,977.9	25.72%	7,710.3	-0.19%	(57.0)
2034	31,090.7	25.84%	8,033.8	31,090.7	25.65%	7,974.8	-0.19%	(59.0)
2035	32,250.6	25.75%	8,304.5	32,250.6	25.56%	8,243.3	-0.19%	(61.2)
2036	33,463.7	25.67%	8,590.1	33,463.7	25.47%	8,523.2	-0.20%	(66.9)
2037	34,728.3	25.59%	8,887.0	34,728.3	25.39%	8,817.5	-0.20%	(69.5)
2038	36,038.3	25.51%	9,193.4	36,038.3	25.31%	9,121.3	-0.20%	(72.1)
2039	37,412.0	25.42%	9,510.1	37,412.0	25.22%	9,435.3	-0.20%	(74.8)
2040	38,851.7	25.33%	9,841.1	38,851.7	25.13%	9,763.4	-0.20%	(77.7)
2041	40,358.6	25.22%	10,178.4	40,358.6	25.03%	10,101.8	-0.19%	(76.6)
2042	41,923.9	15.00%	6,288.6	41,923.9	14.81%	6,208.9	-0.19%	(79.7)
Total:			$191,142.6			$190,095.8		$(1,046.8)

TABLE III

State Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042

($ amounts in millions)

Fiscal Year Ending Jun 30	Current Law Appropriation Payroll	Current Law Employer Contribution Rate	Current Law Employer Contribution Amount	House Bill 2497 as amended by Amendment 07493 Appropriation Payroll	House Bill 2497 as amended by Amendment 07493 Employer Contribution Rate	House Bill 2497 as amended by Amendment 07493 Employer Contribution Amount	Increase / (Decrease) Employer Contribution Rate	Increase / (Decrease) Employer Contribution Amount
2011	$5,936.0	5.64%	$335.0	$5,936.0	5.00%	$296.8	-0.64%	$(38.2)
2012	6,131.9	7.98%	489.0	6,131.9	8.00%	490.6	0.02%	1.6
2013	6,334.2	26.66%	1,688.4	6,334.2	11.50%	728.4	-15.16%	(960.0)
2014	6,543.3	29.22%	1,911.7	6,543.3	16.00%	1,046.9	-13.22%	(864.8)
2015	6,759.2	27.72%	1,873.5	6,759.2	20.50%	1,385.6	-7.22%	(487.9)
2016	6,982.2	27.46%	1,917.0	6,982.2	22.51%	1,572.0	-4.95%	(345.0)
2017	7,212.7	27.09%	1,953.9	7,212.7	22.73%	1,639.1	-4.36%	(314.8)
2018	7,450.7	26.64%	1,985.2	7,450.7	22.82%	1,700.5	-3.82%	(284.7)
2019	7,696.5	26.16%	2,013.4	7,696.5	22.88%	1,761.2	-3.28%	(252.2)
2020	7,950.5	25.69%	2,042.1	7,950.5	22.94%	1,823.7	-2.75%	(218.4)
2021	8,212.9	25.22%	2,071.2	8,212.9	22.99%	1,888.0	-2.23%	(183.2)
2022	8,483.9	24.76%	2,100.9	8,483.9	23.04%	1,954.4	-1.72%	(146.5)
2023	8,763.9	24.32%	2,131.5	8,763.9	23.08%	2,022.9	-1.24%	(108.6)
2024	9,053.1	23.89%	2,163.0	9,053.1	23.13%	2,093.9	-0.76%	(69.1)
2025	9,351.8	23.48%	2,195.5	9,351.8	23.17%	2,167.3	-0.31%	(28.2)
2026	9,660.5	23.07%	2,229.1	9,660.5	23.22%	2,243.2	0.15%	14.1
2027	9,979.3	22.69%	2,263.9	9,979.3	23.27%	2,321.8	0.58%	57.9
2028	10,308.6	22.31%	2,299.7	10,308.6	23.31%	2,403.2	1.00%	103.5
2029	10,648.8	21.94%	2,336.7	10,648.8	23.36%	2,487.3	1.42%	150.6
2030	11,000.2	21.59%	2,375.0	11,000.2	23.40%	2,574.5	1.81%	199.5
2031	11,363.2	21.25%	2,414.5	11,363.2	23.45%	2,664.6	2.20%	250.1
2032	11,738.2	20.92%	2,455.3	11,738.2	23.50%	2,757.9	2.58%	302.6
2033	12,125.5	18.83%	2,283.7	12,125.5	23.54%	2,854.5	4.71%	570.8
2034	12,525.7	17.83%	2,233.3	12,525.7	23.59%	2,954.4	5.76%	721.1
2035	12,939.0	17.37%	2,247.8	12,939.0	23.63%	3,057.8	6.26%	810.0
2036	13,366.0	15.87%	2,121.2	13,366.0	23.68%	3,164.9	7.81%	1,043.7
2037	13,807.1	15.39%	2,125.1	13,807.1	23.72%	3,275.6	8.33%	1,150.5
2038	14,262.7	15.46%	2,205.1	14,262.7	23.77%	3,390.2	8.31%	1,185.1
2039	14,733.4	16.43%	2,420.5	14,733.4	23.82%	3,508.9	7.39%	1,088.4
2040	15,219.6	14.92%	2,270.8	15,219.6	23.86%	3,631.6	8.94%	1,360.8
2041	15,721.8	14.14%	2,223.0	15,721.8	17.90%	2,813.8	3.76%	590.8
2042	16,240.6	13.21%	2,144.7	16,240.6	13.43%	2,181.6	0.22%	36.9
Total:			$65,520.7			$70,857.1		$5,336.4

TABLE IV

Projected Impact on PSERS and SERS Funded Ratios if House Bill 2497 as amended by Amendment 07493 is enacted

	PSERS' Funded Ratio			SERS' Funded Ratio		
Valuation Year	Current Law	Amended House Bill 2497 *	Increase/ (Decrease)	Current Law	Amended House Bill 2497	Increase/ (Decrease)
2009	79.2%	79.2%	0.0%	84.4%	84.4%	0.0%
2010	73.4%	73.9%	0.5%	79.0%	74.7%	-4.3%
2011	66.8%	69.9%	3.1%	72.3%	68.9%	-3.4%
2012	58.3%	66.2%	7.9%	66.4%	62.2%	-4.2%
2013	54.2%	62.8%	8.6%	68.0%	62.1%	-5.9%
2014	55.1%	60.0%	4.9%	68.8%	61.7%	-7.1%
2015	56.7%	57.8%	1.1%	69.8%	61.8%	-8.0%
2016	58.5%	55.8%	-2.7%	70.9%	62.1%	-8.8%
2017	60.5%	53.5%	-7.0%	72.0%	62.5%	-9.5%
2018	62.6%	51.7%	-10.9%	73.2%	63.0%	-10.2%
2019	64.7%	51.6%	-13.1%	74.3%	63.4%	-10.9%
2020	66.8%	51.9%	-14.9%	75.5%	63.9%	-11.6%
2021	68.9%	52.3%	-16.6%	76.6%	64.4%	-12.2%
2022	71.0%	53.0%	-18.0%	77.8%	65.1%	-12.7%
2023	73.0%	53.9%	-19.1%	79.0%	65.8%	-13.2%
2024	75.0%	54.9%	-20.1%	80.2%	66.5%	-13.7%
2025	77.0%	56.1%	-20.9%	81.4%	67.4%	-14.0%
2026	79.0%	57.5%	-21.5%	82.7%	68.4%	-14.3%
2027	80.9%	59.0%	-21.9%	84.0%	69.4%	-14.6%
2028	82.8%	60.5%	-22.3%	85.3%	70.6%	-14.7%
2029	84.6%	62.2%	-22.4%	86.6%	71.8%	-14.8%
2030	86.5%	64.0%	-22.5%	88.0%	73.2%	-14.8%
2031	88.2%	65.9%	-22.3%	89.5%	74.8%	-14.7%
2032	90.0%	67.8%	-22.2%	90.6%	76.4%	-14.2%
2033	91.4%	69.9%	-21.5%	91.6%	78.2%	-13.4%
2034	92.7%	72.1%	-20.6%	92.6%	80.2%	-12.4%
2035	93.8%	74.4%	-19.4%	93.4%	82.3%	-11.1%
2036	94.7%	76.8%	-17.9%	94.1%	84.6%	-9.5%
2037	95.5%	79.3%	-16.2%	94.9%	87.1%	-7.8%
2038	96.2%	82.0%	-14.2%	95.9%	89.9%	-6.0%
2039	97.1%	84.8%	-12.3%	96.7%	92.8%	-3.9%
2040	97.9%	87.7%	-10.2%	97.4%	94.8%	-2.6%

* Assumes FY 2011 rate of 5.64% for PSERS.

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

New Benefit Tiers. The bill as amended would have the effect of reducing the annual benefit accrual rate to 2.0% from 2.5% for Class T-E members of PSERS and Class A-3 members of SERS. Individuals who elect to become members of Class T-F or Class A-4 will earn a higher annual benefit accrual rate of 2.5%, but will be required to make employee contributions of 10.3% and 9.3% of payroll respectively, nominally neutralizing the additional employer costs of providing the higher benefit levels. The bill as amended would also increase the normal retirement age to age 65 for most new classes of service, increase employee contributions relative to benefits earned and increase the service requirement for vesting. The combined effect of the proposed benefit changes will be to reduce the cost to employers of providing benefits earned in the future and increase employee cost sharing.

Normal Cost Calculation. PSERS and SERS use dissimilar methods for calculating the normal cost rate. Under the SERS method, the normal cost is calculated based upon the average new entrant to the system, and under the bill as amended, this method will tend to understate the system's normal cost because that cost will be based on new members earning somewhat diminished benefits. In contrast, the method employed by PSERS, which is based on a more liberal reading of the statute than the SERS interpretation, the normal cost rate reflects the average cost as a percentage of pay from entry into the system reflecting the actual class of membership of each active member. This is the traditional method for calculating the normal cost under the entry age normal actuarial cost method. Using this method, the PSERS' actuary develops a normal cost rate based on a blend of the 2.0% and 2.5% benefit accrual rates and member contribution rates of 5.25%, 6.25%, 6.5%, and 7.5%, depending on each member's date of hire and class of service. The Commission's consulting actuary has indicated that the PSERS' method would be the preferred approach for determining the normal cost for both PSERS and SERS. This is especially important if the reduced benefit classes are adopted for new members in order to avoid having a decrease in the normal cost for current members and an increase in the actuarial accrued liability. Under the PSERS' approach, the normal cost and unfunded actuarial accrued liability would not change for current members, but there would be a reduced normal cost for new members as they join the system. Thus the total normal cost of PSERS would gradually decline as new members are added and current members retire.

Potential for Additional Employer Costs. The higher member contribution rates for Class T-F and Class A-4 were specifically developed to offset, and in the aggregate, neutralize the effect of providing the higher benefit level. The analysis of the bill as amended was performed assuming that the demographics of the new members that elect Class T-F or A-4 are consistent with the demographics of new members that elect Class T-E or A-3, respectively. The actual cost of providing a choice of benefits will depend on a variety of factors, such as the extent to which adverse selection occurs, which could produce higher actual costs. When given a choice, individuals will tend to make decisions that they perceive to be in their best economic interests. In general, individual total normal costs increase as members age. Therefore, if a higher percentage of older members elect the 2.5% benefit accrual rate than do younger members, the potential exists for actual costs to exceed the additional member contributions required of Class T-F and A-4 members resulting in additional employer costs. Other factors that could contribute to additional costs include the extent to which actual plan experience differs from expected experience and the number and characteristics of the members who elect the higher benefit classes differing from the norm. Further, the employer continues to take the risk of investment losses and resulting contribution increases.

Elimination of Option 4. 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. The bill as amended would eliminate this retirement option for most new members of both Systems, resulting in an actuarial gain accruing to both systems.

Appropriateness of Departure from Actuarial Funding Standards. The bill as amended would reduce the actuarially required contribution rate to both PSERS and SERS for several years, effectively delaying the anticipated spike in employer contribution rates projected to begin in 2013. The Commission is well aware of the fiscal challenges facing the Commonwealth resulting from the anticipated pension contribution spike. However, it must be noted that the temporary collared contribution rates proposed in the bill as amended do not follow generally accepted actuarial standards of practice. The short-term effect of the bill as amended would be to defer the payment of actuarially required contributions to both PSERS and SERS, resulting in the underfunding of both retirement systems. This underfunding will permit the continued growth of the Systems' unfunded liabilities resulting in a steady decline in the funded ratios of both PSERS and SERS. The bill as amended appears to be intended to delay the anticipated contribution increases, spread those increases over many future years, but to determine contribution rates in an actuarially sound manner in the long term. The Commonwealth's policymakers must determine whether the temporary departure from actuarial funding proposed by the bill as amended is consistent with the Commonwealth's pension plan funding and fiscal management goals.

Re-amortization of Pension Liabilities. The bill as amended would require PSERS and SERS to re-amortize all of the unfunded actuarial accrued liabilities of their pension trust funds over a 30-year period. The re-amortization of pension plan liabilities is a legitimate actuarial technique. Under the level percentage of pay amortization method proposed in the bill as amended, the unfunded accrued liability of both PSERS and SERS is expected to increase for the first 18 to 20 years, because the amortization payments will be insufficient to pay the interest accruing on the outstanding balance of the unfunded liabilities of the Systems. Contributions in the later years of the amortization period will therefore be much higher to compensate for the years that payments made were less than the interest on the outstanding balance. Therefore, the fresh start re-amortization of liabilities combined with the use of level percent of pay amortization payments will have the advantage of reducing annual employer contribution requirements in the short term, but long term will result in much higher contributions in later years and ultimately in greater total costs to the Commonwealth and other employers.

Extended Smoothing Period. For PSERS, the bill as amended would extend from five years to ten years the smoothing period applicable to the investment gains and losses of the System. The Actuarial Standards Board (ASB) is an entity within the American Academy of Actuaries (AAA) that establishes standards of practice for the actuarial profession in the United States. Actuarial Standards of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, requires that asset smoothing methods must recognize "*the differences from the market value of assets in a sufficiently short period.*" It is the professional opinion of the Commission's consulting actuary that ten years is too long a time period over which to recognize investment gains and losses because such an extended smoothing period has the potential to produce actuarial values of assets that deviate greatly from market values of assets. While the extended smoothing period would have the advantage of delaying the recognition of unfavorable investment experience, it would also have the consequence of delaying recognition of favorable investment experience in future years. In the short-term, the extended smoothing period would serve to mitigate the negative effects of the unprecedented investment losses suffered by PSERS in 2008 by extending the period over which those investment losses are recognized.

New Employer Contribution Floor. The bill as amended would establish the employer normal cost rate as the new employer contribution floor rate for all future years following expiration of the temporary collared contribution rates. Normal cost equates to the value or "cost" of benefits accrued by active members in a given year. By mandating payment of the employer portion of the normal cost rate as the minimum contribution rate for all future years following expiration of the collared contribution rate, the bill as amended would ensure that employer contributions in future years will be adequate to fund the costs of benefits earned in that year. The bill as amended would not impact the cost of benefits already earned (accrued liability), nor would it affect the unfunded liabilities of the Systems.

Technical Drafting Considerations. As drafted, the bill as amended would require any increase in unfunded accrued liability due to the benefit changes to be amortized over a 30-year period using level percentage of pay amortization payments beginning *July 1, 2012* for SERS (07493, page 35, line 28). The Commission staff believes this date reference to be a typographical error and for purposes of the Commission's actuarial note, that the amortization payments should begin *July 1, 2011* for SERS. Additionally, on page 20, line 48 of 07493, the reference to "Class A-3 membership" should read, "Class A-4 membership." The Commission staff has recommended that these technical drafting considerations be addressed by the sponsor.

COMMISSION RECOMMENDATION

On June 15, 2010, 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

A later version of House Bill Number 2497 was signed into law by the Governor on November 23, 2010.

Bill ID: House Bill Number 2497, Printer's Number 3928,
as amended by Amendment Number 09615

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

Subject: New Benefit Tiers and Modifications to Actuarial Funding Requirements

SYNOPSIS

House Bill Number 2497, Printer's Number 3928, as amended by Amendment Number 09615, would amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) to mandate the establishment of new benefit tiers applicable to most new members of both the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS), and modify the actuarial funding requirements of both PSERS and SERS.

The bill as amended would amend the Public School Employees' Retirement Code to:

1) Establish a new class of membership, known as "Class T-E." Any employee who becomes a member of the System after June 30, 2011, would become a member of Class T-E unless the member elects to become a member of the new optional membership class, known as "Class T-F." A Class T-E member would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement equal to 7.5% of compensation;

2) Establish an optional new class of membership, known as "Class T-F." Any employee who becomes a member of the System after June 30, 2011, would have the option of electing Class T-F membership within 45 days of becoming a member of the System. A Class T-F member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 10.3% of compensation;

3) Increase the superannuation requirements for new members (Classes T-E and T-F) to age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 and at least 35 years of credited service;

4) Establish a variable employee contribution rate, known as the "shared risk contribution rate," applicable to new members (Classes T-E and T-F) that is linked to the investment performance of the pension funds;

5) Require new members who purchase most types of nonschool or nonstate service credit (other than intervening military service) to contribute an amount equal to the full actuarial cost of the service purchase;

6) Beginning July 1, 2011, re-amortize all of the unfunded actuarial accrued liabilities of PSERS over a 24-year period using level-percentage of pay amortization payments, including the costs of this bill;

7) Beginning July 1, 2011, extend from five years to ten years the asset smoothing period over which the fund's investment gains and losses are recognized;

8) Fund any increases in accrued liability enacted by legislation, other than the bill, subsequent to June 30, 2010, over a 10-year period using level percentage of pay amortization payments;

9) For the fiscal year beginning July 1, 2010, establish the total employer contribution rate as the "final contribution rate" of 5.0% of the total compensation for all active members, plus the premium assistance contribution rate;

10) Modify employer contribution requirements to PSERS by imposing limits, referred to as "collars" on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total compensation of all active members greater than the prior year's final contribution rate, then the collared contribution rate shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total compensation for all active members;

11) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate;

12) Limit the maximum annual retirement benefit of Class T-E and Class T-F members to not more than 100% of final average salary;

13) Prohibit new members from purchasing Non-Qualifying Part-Time Service (NQPTS); and

14) Prohibit the use of pension obligation bonds for funding liabilities.

The bill as amended would amend the State Employees' Retirement Code to:

1) Establish a new class of membership applicable to most new members (including members of the General Assembly), known as "Class A-3," requiring all new members of the System, other than a member employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, to become a member of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010), including an employee who is not an active member of the System (because membership is optional or prohibited), but who becomes a member of the System on or after January 1, 2011, unless the member elects to become a member of the optional membership class known as "Class A-4." Class A-3 members would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement of 6.25% of compensation;

2) Establish an optional new class of membership, known as "Class A-4." An employee who becomes a member of the System on or after January 1, 2011, would have the option of electing Class A-4 membership within 45 days of becoming a member of the System. A Class A-4 member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 9.3% of compensation;

3) Increase the superannuation requirements for new members (Classes A-3, and A-4) to age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 and at least 35 years of credited service;

4) Establish a variable employee contribution rate, known as the "shared risk contribution rate," applicable to new members (Classes A-3 and A-4) that is linked to the investment performance of the pension funds;

5) Require new members who purchase most types of nonschool or nonstate service credit (other than intervening military service) to contribute an amount equal to the full actuarial cost of the service purchase;

6) Beginning July 1, 2010, re-amortize all of the unfunded actuarial accrued liabilities of SERS, including previously enacted supplemental annuities, over a 30-year period using level-dollar amortization payments, instead of level percentage of pay amortization payments including the costs of this bill;

7) Maintain the current five-year smoothing period over which investment gains and losses are recognized;

8) Fund any increase in accrued liability enacted by legislation, other than the bill, subsequent to December 31, 2009, over a 10-year period using level-dollar amortization payments;

9) For the fiscal year beginning July 1, 2010, establish the total employer contribution rate as the "final contribution rate" of 5.0% of the total compensation for all active members;

10) Modify employer contribution requirements to SERS by imposing limits, referred to as "collars," on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total compensation of all active members greater than the prior year's final contribution rate, then the collared contribution rate shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total compensation for all active members;

11) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate; and

12) Prohibit the use of pension obligation bonds for funding liabilities.

DISCUSSION

The Retirement Codes and Systems

The Public School Employees' Retirement Code and the State Employees' Retirement Code (Codes) are governmental, cost-sharing, multiple-employer pension plans. The designated purpose of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS) is to provide retirement allowances and other benefits, including disability and death benefits to public school and state employees. As of June 30, 2009, there were approximately 754 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS, and approximately 107 Commonwealth and other employers participating in SERS.

Membership in PSERS and SERS 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, 2009, there were 279,701 active members and 177,963 annuitant members of PSERS, and as of December 31, 2009, there were 110,107 active members and 109,639 annuitant members of SERS.

For most members of both Systems, the basic benefit formula used to determine the normal retirement benefit is equivalent to the product of 2.5% multiplied by the member's years of accumulated service credit ("eligibility points") multiplied by the member's final average (highest three years) salary. Since the passage of Act 9 of 2001 (which increased the accrual rate for most members from 2.0% to 2.5%), most members of PSERS are Class T-D members and contribute 7.5% of pay to the System, while most members of SERS are Class AA members and contribute 6.25% of pay to the System. Within both Systems, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school and state employees.[1]

Under the Codes of both Systems, superannuation or normal retirement age is that date on which a member may terminate service with the public employer and receive a full retirement benefit without reduction. 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 at least 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.

Prior to the passage of Act 9 of 2001, the annual benefit accrual rate applicable to most members of PSERS and SERS was 2.0%. Act 9, through the creation of several new classes of membership in the Systems (Class T-D in PSERS; Class AA and Class D-4 in SERS), effectively increased the benefit accrual rates for most PSERS and SERS members from 2.0% to 2.5% (for members of the General Assembly who elected membership in Class D-4, the annual benefit accrual rate increased to 3.0%). Because Act 9 was applicable to all periods of school and State service, both retrospective and prospective, the effect of the increased benefit accruals was to enhance the value of most members' retirement benefits by 25% (50% for D-4 members of the General Assembly).

New Benefit Tiers

The bill as amended would mandate the establishment of new benefit tiers applicable to new members of both Systems through the creation of additional membership classes. The bill as amended would amend each retirement Code in the following manner:

1) The Public School Employees' Retirement Code, effective July 1, 2011, to create two new classes of membership for school employees, known as "Class T-E," and "Class T-F." New members of the System would become members of Class T-E beginning July 1, 2011. Class T-E members would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement of 7.5% of compensation. Additionally, the bill as amended would create an optional new class of membership, known as "Class T-F." Any employee who

[1] Both PSERS and SERS utilize a number of "membership classes," each with its corresponding "class of service multiplier" that is multiplied by a base accrual rate to determine the member's benefit, rather than a simple accrual rate applied to all members. The exception is PSERS membership Class T-D, for which the accrual rate is specified as 2.5% annually. (See PSERS Code Section 8102, definition of "Standard Single Life Annuity" and "Class of Service Multiplier." See SERS Code Section 5102, definition of "Class of Service Multiplier.")

becomes a member of the System after June 30, 2011, would have the option of electing Class T-F membership within 45 days of becoming a member of the System. A Class T-F member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 10.3% of compensation. A member who fails to elect Class T-F within 45 days of becoming a member of the System would automatically become a member of Class T-E. Current Class T-D members of the System who have a future break in service would remain members of Class T-D upon their return.

2) The bill as amended would amend the State Employees' Retirement Code, effective January 1, 2011, to create two new classes of membership for State employees (including members of the General Assembly), known as "Class A-3," and "Class A-4." Most new members of the System, other than a State Police officer or a member employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, would become members of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010), including an employee who is not an active member of the System (because membership is optional or prohibited), but who becomes a member of the System on or after January 1, 2011. Class A-3 members would be eligible for an annuity based upon an annual benefit accrual rate of 2% and would have a corresponding employee contribution requirement of 6.25% of compensation. Additionally, the bill as amended would create an optional new class of membership, known as "Class A-4." An employee who becomes a member of the System on or after January 1, 2011, would have the option of electing Class A-4 membership within 45 days of becoming a member of the System. A Class A-4 member would be eligible for an annuity based upon an annual benefit accrual rate of 2.5% and would have a corresponding employee contribution requirement equal to 9.3% of compensation. A member who fails to elect Class A-4 within 45 days of becoming a member of the System would automatically become a member of Class A-3. Current Class AA members of the System who have a future break in service would remain members of Class AA upon their return.

The bill as amended would amend the Codes of both PSERS and SERS as follows:

1) **Vesting:** Increase the vesting requirements for new members from 5 years to 10 years.

2) **Superannuation:** Increase the superannuation requirements for new members (Classes A-3, A-4, T-E, and T-F) to age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 and at least 35 years of credited service. In the case of PSERS members, the option of superannuating at age 60 with 30 years of service would be eliminated for new members. Members of the General Assembly who become members of Class A-3 or A-4 on or after December 1, 2010, would become eligible for a superannuation annuity at age 55. For all other members (including State police officers) who currently superannuate at age 50, superannuation for Class A-3 and Class A-4 members would increase to age 55. For park rangers and Capitol police officers who currently superannuate at age 50 with 20 years of park ranger or Capitol police officer service, superannuation would increase to age 55 with 20 years of park ranger or Capitol police officer service.

3) **Shared Risk Contribution Rate:** Establish a variable employee contribution rate, known as the "shared risk contribution rate" applicable to new members (Classes A-3, A-4, T-E, and T-F). The shared risk contribution rate is tied to the investment performance of each System's pension fund and would be added to the basic contribution rate of each membership class under certain conditions. For PSERS, beginning with the

annual actuarial valuation performed for the period ending June 30, 2014, and for SERS, beginning with the December 31, 2013, valuation, and every 3 years thereafter, each System will compare the actual investment rate of return, net of fees, to the actuarial assumed rate of return for the previous 10-year period. If the actual rate of return is less than the assumed rate by 1% or more, the total member contribution rate will increase by ½% per year, up to a maximum total increase of 2.0%. If the actual rate is equal to or more than the assumed rate, the total member contribution rate will decrease by ½%. New hires will contribute at the rate in effect when they are hired. The additional shared risk contributions will be used to reduce the unfunded accrued liabilities of the Systems. If the System is fully funded at the time of the comparison, then the shared risk rate will be zero for that period. For any year in which the employer contribution rate is lower than the final contribution rate, the employee contribution rate would be the basic contribution rate. There would be no increase in the employee contribution rate where there has not been an equivalent increase to the employer contribution rate over the previous three-year period. Until there is a full 10-year "look back" period, the look back period will begin as of the effective date of the act.

4) **Purchase of Service:** Require new members of both PSERS and SERS who purchase most types of nonschool or nonstate service credit (other than intervening military service for SERS, and both intervening and nonintervening military service for PSERS) to contribute an amount equal to the full actuarial cost of the service purchase.

5) **Waiver of Contributions:** Restrict new members from waiving their member contributions if the Maximum Single Life Annuity benefit is greater than or equal to 110% of the member's highest year salary.

6) **Option 4:** Eliminate members' eligibility to withdraw their accumulated deductions in a lump sum at retirement under retirement Option 4.

Both current and new members of the judiciary will be unaffected by the benefit changes. Officers of the Pennsylvania State Police who become members of SERS on or after January 1, 2011, would receive Class A-3 service credit and benefits until they become eligible for the enhanced State Trooper retirement benefits upon attaining 20 years of credited service. A current Class D-4 member of the General Assembly who leaves service and later returns to the General Assembly will retain Class D-4 membership.

The bill as amended would not affect the retirement benefit rights of current active members of the Systems. Instead, the bill as amended seeks to create new benefit tiers within PSERS and SERS applicable only to employees who become members of PSERS and SERS on or after July 1, 2011, in the case of PSERS and January 1, 2011, in the case of SERS.

In Pennsylvania, public employee retirement benefits are recognized as deferred compensation for work already performed, which confers upon public employees certain contractual rights protected by the Pennsylvania Constitution (Article I Section 17).[2] *Police Officers of Hatboro v. Borough of Hatboro,* 559 A.2d 113 (Pa. Cmwlth 1989); *McKenna v. State Employees' Retirement Board,* 495 Pa. 324, 433 A.2d 871 (1981); *Catania v. State Employees' Retirement Board,* 498 Pa. 684, 450 A.2d (1982). These contractual pension rights become fixed upon the employee's entry into the retirement system and cannot be subsequently unilaterally diminished or adversely affected,

[2]The Pa. Constitution provides: "No ex post facto law, nor any law impairing the obligations of contract, … shall be passed."

regardless of whether (1) the member is vested; or (2) the devaluation is necessary for actuarial soundness. *Association of Pa. State College and University Faculties v. State System of Higher Education,* 505 Pa. 369, 479 A.2d 962 (1984). See also *Hughes v. Public School Employees' Retirement Board*, 662 A.2d 701 (Pa. Cmwlth. 1995), *alloc. denied,* 542 Pa. 678, 668 A.2d 1139 (1995) (member has property interest in pension benefit).

By creating new benefit tiers applicable only to school or State employees who become members of PSERS or SERS, the bill as amended avoids impairing the contractual retirement benefit rights of current members of the Systems, while having the effect of creating a new contractual relationship between the public employer and new members of the Systems.

Section 8328 of the PSERS Code and Section 5508 of the SERS Code specify similar methods to be used by the actuaries of the respective systems to determine the "employer normal contribution rate" or employer normal cost and the total employer contribution rate, which consists of both the normal cost and the contributions required to fund the accrued liabilities of each plan, plus any amortization contribution requirement.

Both the PSERS and SERS Codes require the normal cost to be determined using "... a level percentage of the compensation of the average new active member...." However, the Systems apply different interpretations to the language. Using the SERS interpretation, the average new member, or entrant, to the Systems currently earns a benefit at the 2.5% annual accrual rate. However, if enacted, the bill would require new entrants to the Systems to earn benefits at a reduced 2.0% accrual rate. This would result in a diminished normal cost calculation that would tend to understate the true cost of SERS, because in the early years of the reduced benefit tier, the majority of members would remain in a benefit class entitling them to an annual benefit accrual of 2.5%. In the short term, the understated normal cost could generate an unfunded actuarial accrued liability in SERS. This would occur because reducing the benefit accrual rate for new members only would not affect the present value of benefits for current members, but would affect the normal cost calculation.

The traditional method would be to develop the normal cost rate based upon current active members and the benefits to which each member is entitled. This method would be based upon a blending of accrual rates attributable to all active members, rather than new entrants only, and would result in a normal cost calculation that more closely approximates the normal costs of the Systems. The traditional method would also help to achieve the presumed cost reduction goals of the bill by both reducing the normal cost of the Systems and preventing the creation of the unfunded actuarial accrued liabilities that would otherwise result from enactment of the bill. According to the Commission's consulting actuary, PSERS is currently using the traditional normal cost method.

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. 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. A member may elect to receive this withdrawal in one lump sum or in up to four installment payments. The installments 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.

Under the bill as amended, the election to withdraw the member's accumulated deductions under Option 4 would be eliminated as an option for new members of PSERS and SERS who otherwise would be eligible to receive retirement benefits. Members of Class T-E , T-F, A-3 and A-4 who terminate service before vesting would continue to be entitled to withdraw their accumulated deductions plus the interest earned on those contributions upon termination of service, in lieu of any claim to other benefits.

Unfunded Liabilities and Amortization Periods

Generally, the overall funding objective of a public employee pension plan is to provide reserves sufficient to fund the benefits of plan members when those benefits become due and to fund, over time, any unfunded liability through installment payments. As the funded ratio (ratio of assets to liabilities) of a pension plan declines below 100%, the plan's assets represent an increasingly smaller portion of the System's accrued liabilities. A pension trust fund in which the value of the actuarial accrued liabilities exceeds the actuarial value of assets is said to have an unfunded actuarial accrued liability. This funding shortfall may occur for many reasons, including benefit liberalizations, unfavorable investment or other actuarial experience, changes in major economic or demographic assumptions, or underfunding of the System by the employer. Based upon the June 30, 2009, actuarial valuation for PSERS, the retirement System reported unfunded actuarial accrued liabilities totaling $15.7 billion, representing a funded ratio of 79.2%. Based upon the December 31, 2009, actuarial valuation for SERS, the retirement System reported unfunded actuarial accrued liabilities totaling $5.6 billion, representing a funded ratio of 84.4%.

The unfunded actuarial accrued liability existing in a pension trust fund must be amortized over time through installment payments. Under the Codes of both Systems, the permissible amortization periods are either 10 years or 30 years, depending upon the source of the liability. Subsequent to the passage of Act 40 of 2003, the amortization period for: 1) the increased liabilities of Act 9 of 2001; 2) the outstanding balances of the net actuarial losses incurred by PSERS in fiscal years 2000-01 and 2001-02 and by SERS in calendar year 2002; and 3) the gains and losses experienced in all future years is 30 years rather than 10 years, with the amortization contributions calculated as level-dollar payments. Amortization of the remaining balance of the pre-Act 9 of 2001 unfunded actuarial accrued liability, the future unfunded actuarial accrued liabilities attributable to benefit changes, including supplemental annuities, and in the case of PSERS, the gains and losses attributable to the change in the asset valuation methodology under Act 38 of 2002 continue to be amortized over 10 years on a level-dollar basis.

Based on current projections, the Commonwealth will experience large increases in employer contributions beginning in fiscal year 2012-2013, when the unfunded liability portion of the employer contribution rate begins to sharply increase. This employer contribution "rate spike" is the result of large unfunded liabilities generated by four major factors: 1) the two major market down turns during the past decade, from roughly 2001-2003 and again in 2008; 2) the benefit enhancement provided to active members of both PSERS and SERS by the passage of Act 9 of 2001; 3) the additional unfunded liability resulting from the two-tier cost-of-living adjustment provided to retired PSERS and SERS members by Act 38 of 2002; and 4) changes to funding methods resulting from the enactment of Act 38 of 2002 and Act 40 of 2003. Combined, Acts 38 and 40 had the effect of deferring the funding of liability. Of the two, Act 40 had the greatest impact by requiring PSERS and SERS to amortize certain gains and losses over different periods of time. Under Act 40, the recognition of pre-Act 9 gains was accelerated by amortizing these gains over a 10-year period, while the recognition of post-Act 9 losses was delayed by amortizing these losses over 30 years. The result was, in effect, a mismatch of the amortization of gains and losses, generating a 10-year credit that has suppressed the employer contribution rate and masked the true costs of the Systems. This 10-year credit will be fully amortized by fiscal year 2012-2013, which, not coincidentally, corresponds with the first year of the projected contribution rate spike.

The bill as amended would restructure the amortization periods of both PSERS and SERS for the fiscal years beginning July 1, 2011, and July 1, 2010, respectively. The bill as amended would require the Systems to re-amortize all of the unfunded actuarial accrued liabilities of their pension trust funds. In the case of PSERS, the liabilities would be reamortized over a 24- year period using level-percentage of pay amortization payments. In the case of SERS, the liabilities would be reamortized over a 30-year period using level-dollar amortization payments. This "fresh start" of the amortization bases would have the effect of extending the amortization of the Systems' current pension liabilities, resulting in a reduction in the Systems' annual amortization contribution requirements.

For PSERS, the bill as amended would also require the use of a level-percentage of pay amortization method, rather than the level-dollar method currently used by both PSERS and SERS. Compared to the level-dollar amortization method, which results in level installment payments throughout the course of the amortization period, the level-percentage of pay method will produce amortization payments that are generally lower than would be the case under the level-dollar method in the early years of the amortization period, but steadily rise by a level percentage of pay using PSERS' assumed annual payroll increase assumption (4.0%). Although the level-percentage of pay amortization method has the advantage of helping reduce annual employer contribution requirements in the early years, this method will result in steadily escalating contribution requirements.

Additionally, increases in accrued liability caused by legislation enacted subsequent to June 30, 2010, for PSERS, and subsequent to December 31, 2009, for SERS, would continue to be amortized over a 10-year period, but in the case of PSERS, would use level percentage of pay amortization payments instead of level-dollar payments.

Asset Smoothing

In public pension systems, asset "smoothing" involves the gradual recognition of investment gains and losses over time and is part of the method used to determine the actuarial value of assets in a pension trust fund. One purpose of the various smoothing methods is to avoid large year-to-year fluctuations in employer contribution requirements that may otherwise result from volatility in the investment markets.

Both PSERS and SERS currently apply a 5-year smoothing period to recognize investment gains and losses. The bill as amended would preserve the 5-year smoothing period for SERS, but for PSERS, the bill as amended would extend from 5 years to 10 years the smoothing period applicable to investment gains and losses. The Actuarial Standards Board (ASB) is an entity within the American Academy of Actuaries (AAA) that establishes standards of practice for the actuarial profession in the United States. Actuarial Standards of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, requires that asset smoothing methods must recognize "*the differences from the market value of assets in a sufficiently short period.*" It is the professional opinion of the Commission's consulting actuary that ten years is too long a time period over which to recognize investment gains and losses because such an extended smoothing period has the potential to produce actuarial values of assets that deviate greatly from market values of assets. While the extended smoothing period would have the effect of delaying the recognition of unfavorable investment experience, it would also have the consequence of delaying recognition of favorable investment experience in future years. In the short-term, the extended smoothing period would serve to mitigate the negative effects of the unprecedented investment losses suffered by PSERS in 2008 by extending the period over which those investment losses are recognized.

Modification of Employer Contribution Requirements

PSERS and SERS are funded through: 1) employer contributions, 2) employee contributions, and 3) returns on investments. The employer normal contribution rate represents the employer portion of the value or cost (normal cost) of the benefits earned during a given year, based upon the Systems' actuarial funding methods.

Like most large defined benefit public employee retirement systems throughout the United States, PSERS and SERS both utilize variations of the entry age normal actuarial cost method. The entry age normal cost method allocates the annual cost of all future benefits to be paid by the plan by spreading those costs over the entire period of a member's service from the date of entry to the member's anticipated date of retirement. These costs are expressed both as a dollar amount and as a percentage of actual or projected payroll. This method results in the calculation of two costs: 1) the annual contributions required to establish sufficient reserves to support future retirement benefits when made from entry age to normal retirement age is the normal cost; and 2) the aggregate normal cost of all members of the plan for prior years of service is the actuarial accrued liability. If assets of the plan are less than the accrued liability, then a deficit exists. This deficit is known as an unfunded actuarial accrued liability. Because this liability has not been accounted for or funded, it must be amortized through annual payments over a specified number of years, and the required annual payments are reflected in the total determination of employer annual cost.

The employer contribution requirements for both PSERS and SERS are determined using the employer portion of the employer normal cost, plus any amortization contribution requirements necessary to amortize the unfunded liabilities of the System over the statutorily specified amortization time periods as modified by the experience adjustment factor. The experience adjustment factor is a reference to the experience of the pension funds, most importantly, the investment experience of those funds. If gains from positive plan experience are greater than expected, employer contributions may be reduced. Conversely, losses from negative plan experience require additional employer contributions to compensate for those losses.

The bill as amended would modify the methods currently used to determine the employer contribution requirements for both PSERS and SERS by imposing limits, referred to as "collars" on the rate at which employer contributions may rise from year-to-year. For the fiscal year beginning July 1, 2010, the total employer contribution rate for each System, referred to in the bill as the "final contribution rate," would be modified. In the case of PSERS, the modified contribution rate would be 5.0% plus the premium assistance contribution rate. In the case of SERS, the contribution rate would be fixed at 5.0%, plus the benefit completion plan contribution rate. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, the bill as amended would establish temporary collared contribution rates, equal to 3%, 3.5% and 4.5%, for each year respectively. The collars would apply only if the calculation of the employer contribution rate results in an actuarially required contribution rate that is greater than the collared rate. The effect would be to limit the year-to-year increase in the employer contribution rate by the percentage amounts specified for each year. Beginning with the July 1, 2013, fiscal year, and for each year thereafter, the bill as amended would limit the annual increase in employer contributions to no more than 4.5%, until such time as the actuarially required contribution rate calculated by the Systems' actuaries results in an increase in the employer rate that is less than the collared rate of 4.5%. At this point, the collared contribution limits would expire and a new employer contribution floor rate equal to each System's employer normal cost rate would be established.

As described previously, the fiscal challenges facing employers and the Commonwealth resulting from the much publicized pension "rate spike" are significant. However, it should be noted that the employer contribution collars proposed in the bill represent a departure from the norms of actuarial funding practice. The effect of the bill as amended would be to suppress the employer contributions to both PSERS and SERS resulting in significant underfunding of both retirement systems.

Establishment of Employer Normal Cost Rate as Minimum Employer Contribution Floor

Act 38 of 2002 first established a 1% minimum employer contribution rate for both PSERS and SERS. In 2003, the mandated rate was increased through the enactment of Act 40 of 2003 for both Systems. For PSERS, the minimum employer contribution rate was increased effective July 1, 2004, from 1% to 4% plus the premium assistance contribution rate. For SERS, the rate was increased from 1% to: 1) 2% beginning July 1, 2004; 2) 3% beginning July 1, 2005; and 3) 4% beginning July 1, 2006. Act 8 of 2007 extended and made permanent the 4% employer floor rate for SERS.

The bill as amended would establish the employer normal cost rate as the new employer contribution floor rate for all future years following expiration of the temporary collared contribution rates. By mandating payment of the employer normal contribution rate as the minimum or floor rate for all future years following expiration of the collared contribution rate, the bill as amended would ensure that employer contributions in future years will be adequate to fund the costs of benefits earned in that year. The bill as amended would not impact the cost of benefits already earned (accrued liability), nor would it directly affect the unfunded liabilities of the Systems.

Miscellaneous Provisions

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. Act 9 of 2001 amended the Codes of both PSERS and SERS to expand the multiple service election period from 30 days to 365 days, requiring six changes to the existing statutes: three in the PSERS Code and three in the SERS Code. One of the changes to the SERS Code was inadvertently overlooked. The bill as amended would correct this technical oversight to make the language consistent with the clear intent of the General Assembly. In practice, SERS has been administering the multiple service provision based on a 365-day election period. The bill as amended also makes numerous changes to the Codes of both Systems that are of a technical, administrative, or editorial nature.

Non-Qualified Part-Time Service (NQPT): Under current law, active members of PSERS are permitted to purchase previous periods of part-time school service, referred to as Non-Qualified Part-Time Service (NQPT). The bill as amended would eliminate the service purchase entitlement for new members, however, the necessity for such purchases of service would also be eliminated by removing the annual membership qualification requirement currently in the PSERS Code. Under the bill as amended, once membership as a part-time employee is established, all future school service would be considered creditable service. Current members will have a three-year window within which to elect to purchase any previous NQPT service. Any T-C or T-D members who become active members following the effective date of the act will be afforded a one-year service purchase window.

Prohibition on use of Pension Obligation Bonds: The bill as amended would prohibit te issuance of pension obligation bonds as a means for funding the liabilities of PSERS and SERS.

SUMMARY OF ACTUARIAL COST IMPACT

With respect to the new benefit tiers established by the bill as amended, the Commission's consulting actuary has reviewed the bill and determined the actuarial cost impact based upon current statutory provisions of the PSERS and SERS Codes specifying the methods for calculating the employer normal contribution rate. For SERS, because the employer normal contribution calculation is based upon a level percentage of the compensation of the average new member, the resulting normal cost would tend to understate the employer normal cost. This is largely due to the fact that the majority of members in the early years would remain in the higher benefit accrual group (2.5%), while the normal cost calculation would be based upon the average new entrant who, under the bill, would receive a diminished annual benefit accrual (2.0%).

The Commission's consulting actuary has reviewed the bill as amended and the actuarial cost estimates provided to the Commission by the consulting actuaries for both PSERS and SERS. The results of these analyses are summarized in the following four tables. Table I shows the employer contribution rate and the employer contribution amount for PSERS for FY 2011 to FY 2044 under (1) current law and (2) under the bill as amended. Under the PSERS methodology, the projected appropriation payroll differs under the bill as amended because of the changes to superannuation age and vesting resulting in a different pattern of expected terminations and retirements.

Table II shows the employer contribution rate and the employer contribution amount for SERS for FY 2011 to FY 2044 under (1) current law and (2) under the bill as amended. Under the SERS methodology, there is no change in appropriation payroll as the payroll is assumed to increase 3.3% per year.

As indicated in Tables I and II, the anticipated spike in the employer contribution rate in FY 2013 under current law would be delayed if the bill as amended is enacted. Based on the projections provided by the Systems' actuaries, the increased contributions would be phased-in over time. The actuarially required contribution rate would be reached in FY 2016 for PSERS and FY 2017 for SERS and the collared contribution rates would expire. The employer contribution rate for PSERS increases to 24.2% in FY 2016 and then increases to between 25% and 27.8% for FY 2017 to FY 2035 before decreasing to 16% for FY 2036 and declines gradually reaching 5.1% in FY 2044. The employer contribution rate for SERS increases to 28.25% for FY 2017 and gradually declines to 17.3% in FY 2040 and then decreases further, reaching 7.60% in FY 2044.

The deferral in making actuarially required contributions and the changes in the amortization of the unfunded accrued liability is partially offset by the reduced benefits provided to new members. As shown in the tables, the total employer contributions for the entire period FY 2011 to FY 2044 would decrease by about 1% or $1.4 billion for PSERS and 2% or $1.5 billion for SERS from the existing law.

Table III for PSERS and Table IV for SERS compares the projected employer contribution rates for FY 2011 to FY 2042 for (1) the Commission's previous actuarial note on House Bill Number 2497, Printer's Number 3853, as amended by Amendment Number 07493 (which subsequently became House Bill Number 2497, Printer's Number 3928) and (2) House Bill Number 2497, Printer's Number 3928, as amended by Amendment Number 09615. In addition to the changes introduced by Amendment Number 09615, the projections for PSERS reflect the difference due to the FY 2010 investment return of 14.59% projected by PSERS. As the Tables III and IV clearly show, the difference in total employer contributions between the two versions of the bill is quite significant, amounting to a reduction of approximately $27.2 billion for PSERS and $5.8 billion for SERS.

TABLE I

Public School Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2044
($ amounts in millions)

Fiscal Year Ending June 30	Current Law			House Bill 2497 as amended by Amendment 09615			Increase / (Decrease)	
	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Employer Contribution Rate	Employer Contribution Amount
2011	$13,510	5.64%	$762	$13,510	5.64%	$762	0.00%	$0
2012	13,921	10.22%	1,423	13,921	8.72%	1,214	-1.50%	(209)
2013	14,345	28.71%	4,119	14,345	12.22%	1,753	-16.49%	(2,366)
2014	14,798	31.20%	4,617	14,791	16.71%	2,472	-14.49%	(2,145)
2015	15,280	32.35%	4,943	15,268	21.20%	3,237	-11.15%	(1,706)
2016	15,795	31.66%	5,001	15,777	24.24%	3,824	-7.42%	(1,177)
2017	16,341	31.13%	5,087	16,326	25.13%	4,103	-6.00%	(984)
2018	16,927	30.47%	5,158	16,905	25.92%	4,382	-4.55%	(776)
2019	17,558	29.71%	5,216	17,527	26.83%	4,703	-2.88%	(513)
2020	18,232	28.91%	5,271	18,194	27.55%	5,012	-1.36%	(259)
2021	18,948	28.11%	5,326	18,906	27.58%	5,214	-0.53%	(112)
2022	19,703	27.35%	5,389	19,659	27.68%	5,442	0.33%	53
2023	20,494	26.60%	5,451	20,439	27.73%	5,668	1.13%	217
2024	21,322	25.88%	5,518	21,258	27.75%	5,899	1.87%	381
2025	22,185	25.19%	5,588	22,115	27.75%	6,137	2.56%	549
2026	23,082	24.54%	5,664	23,006	27.70%	6,373	3.16%	709
2027	24,007	23.89%	5,735	23,925	27.63%	6,611	3.74%	876
2028	24,959	23.29%	5,813	24,865	27.56%	6,853	4.27%	1,040
2029	25,937	22.72%	5,893	25,831	27.49%	7,101	4.77%	1,208
2030	26,944	22.17%	5,973	26,826	27.41%	7,353	5.24%	1,380
2031	27,978	21.65%	6,057	27,849	27.32%	7,608	5.67%	1,551
2032	29,042	21.15%	6,142	28,902	27.23%	7,870	6.08%	1,728
2033	30,136	18.54%	5,587	29,978	27.17%	8,145	8.63%	2,558
2034	31,268	17.28%	5,403	31,091	27.09%	8,422	9.81%	3,019
2035	32,446	15.97%	5,182	32,251	26.99%	8,704	11.02%	3,522
2036	33,676	14.83%	4,994	33,464	15.65%	5,237	0.82%	243
2037	34,957	13.54%	4,733	34,728	14.45%	5,018	0.91%	285
2038	36,292	13.12%	4,762	36,038	12.64%	4,555	-0.48%	(207)
2039	37,691	13.91%	5,243	37,412	11.00%	4,115	-2.91%	(1,128)
2040	39,153	13.77%	5,391	38,852	9.58%	3,722	-4.19%	(1,669)
2041	40,680	12.47%	5,073	40,359	8.39%	3,386	-4.08%	(1,687)
2042	42,267	11.65%	4,924	41,924	7.32%	3,069	-4.33%	(1,855)
2043	43,915	10.59%	4,651	43,550	6.13%	2,670	-4.46%	(1,981)
2044	45,628	9.29%	4,239	45,239	5.11%	2,312	-4.18%	(1,927)
Total:			$170,328			$168,946		$(1,382)

TABLE II

State Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2044
($ amounts in millions)

Fiscal	Current Law			House Bill 2497 as amended by Amendment 09615			Increase / (Decrease)	
Year Ending	Appropriation	Employer Contribution		Appropriation	Employer Contribution		Employer Contribution	
June 30	Payroll	Rate	Amount	Payroll	Rate	Amount	Rate	Amount
2011	$5,936	5.00%	$297	$5,936	5.00%	$297	0.00%	$0
2012	6,132	8.00%	491	6,132	8.00%	491	0.00%	0
2013	6,334	26.71%	1,692	6,334	11.50%	728	-15.21%	(964)
2014	6,543	29.27%	1,915	6,543	16.00%	1,047	-13.27%	(868)
2015	6,759	27.77%	1,877	6,759	20.50%	1,386	-7.27%	(491)
2016	6,982	27.51%	1,921	6,982	25.00%	1,746	-2.51%	(175)
2017	7,213	27.14%	1,957	7,213	28.25%	2,037	1.11%	80
2018	7,451	26.69%	1,989	7,451	27.79%	2,071	1.10%	82
2019	7,697	26.21%	2,017	7,697	27.15%	2,090	0.94%	73
2020	7,951	25.73%	2,046	7,951	26.52%	2,109	0.79%	63
2021	8,213	25.26%	2,075	8,213	25.91%	2,128	0.65%	53
2022	8,484	24.81%	2,105	8,484	25.31%	2,148	0.50%	43
2023	8,764	24.36%	2,135	8,764	24.73%	2,168	0.37%	33
2024	9,053	23.93%	2,167	9,053	24.17%	2,188	0.24%	21
2025	9,352	23.52%	2,199	9,352	23.63%	2,210	0.11%	11
2026	9,661	23.11%	2,233	9,661	23.10%	2,232	-0.01%	(1)
2027	9,979	22.72%	2,267	9,979	22.59%	2,255	-0.13%	(12)
2028	10,309	22.34%	2,303	10,309	22.10%	2,278	-0.24%	(25)
2029	10,649	21.98%	2,340	10,649	21.62%	2,302	-0.36%	(38)
2030	11,000	21.62%	2,379	11,000	21.16%	2,327	-0.46%	(52)
2031	11,363	21.28%	2,418	11,363	20.71%	2,353	-0.57%	(65)
2032	11,738	20.95%	2,459	11,738	20.28%	2,380	-0.67%	(79)
2033	12,126	18.86%	2,287	12,126	19.86%	2,408	1.00%	121
2034	12,526	17.86%	2,237	12,526	19.45%	2,436	1.59%	199
2035	12,939	17.40%	2,251	12,939	19.06%	2,466	1.66%	215
2036	13,366	15.90%	2,125	13,366	18.68%	2,496	2.78%	371
2037	13,807	15.42%	2,129	13,807	18.31%	2,528	2.89%	399
2038	14,263	15.49%	2,209	14,263	17.95%	2,560	2.46%	351
2039	14,733	16.45%	2,424	14,733	17.60%	2,594	1.15%	170
2040	15,220	14.94%	2,274	15,220	17.27%	2,628	2.33%	354
2041	15,722	14.16%	2,227	15,722	13.79%	2,167	-0.37%	(60)
2042	16,241	13.22%	2,147	16,241	11.13%	1,807	-2.09%	(340)
2043	16,777	12.02%	2,017	16,777	9.47%	1,589	-2.55%	(428)
2044	17,330	10.59%	1,835	17,330	7.60%	1,317	-2.99%	(518)
Total:			$69,444			$67,967		$(1,477)

TABLE III

Public School Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042
($ amounts in millions)

Fiscal Year Ending June 30	House Bill 2497 as amended by Amendment 07493 with 5.64% employer contribution rate for FY 2011			House Bill 2497 as amended by Amendment 09615			Increase / (Decrease)	
	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Employer Contribution Rate	Employer Contribution Amount
2011	$13,510	5.64%	$762	$13,510	5.64%	$762	0.00%	$0
2012	13,921	8.72%	1,214	13,921	8.72%	1,214	0.00%	0
2013	14,345	12.22%	1,753	14,345	12.22%	1,753	0.00%	0
2014	14,792	16.71%	2,472	14,791	16.71%	2,472	0.00%	0
2015	15,268	21.20%	3,237	15,268	21.20%	3,237	0.00%	0
2016	15,777	22.71%	3,583	15,777	24.24%	3,824	1.53%	241
2017	16,326	23.52%	3,840	16,326	25.13%	4,103	1.61%	263
2018	16,905	24.34%	4,115	16,905	25.92%	4,382	1.58%	267
2019	17,528	25.27%	4,429	17,527	26.83%	4,703	1.56%	274
2020	18,194	26.02%	4,734	18,194	27.55%	5,012	1.53%	278
2021	18,906	26.17%	4,948	18,906	27.58%	5,214	1.41%	266
2022	19,659	26.29%	5,168	19,659	27.68%	5,442	1.39%	274
2023	20,439	26.37%	5,390	20,439	27.73%	5,668	1.36%	278
2024	21,258	26.41%	5,614	21,258	27.75%	5,899	1.34%	285
2025	22,115	26.41%	5,841	22,115	27.75%	6,137	1.34%	296
2026	23,006	26.39%	6,071	23,006	27.70%	6,373	1.31%	302
2027	23,925	26.33%	6,300	23,925	27.63%	6,611	1.30%	311
2028	24,865	26.27%	6,532	24,865	27.56%	6,853	1.29%	321
2029	25,831	26.21%	6,770	25,831	27.49%	7,101	1.28%	331
2030	26,826	26.13%	7,010	26,826	27.41%	7,353	1.28%	343
2031	27,849	26.06%	7,258	27,849	27.32%	7,608	1.26%	350
2032	28,902	25.98%	7,509	28,902	27.23%	7,870	1.25%	361
2033	29,978	25.91%	7,767	29,978	27.17%	8,145	1.26%	378
2034	31,091	25.84%	8,034	31,091	27.09%	8,422	1.25%	388
2035	32,251	25.75%	8,305	32,251	26.99%	8,704	1.24%	399
2036	33,464	25.67%	8,590	33,464	15.65%	5,237	-10.02%	(3,353)
2037	34,728	25.59%	8,887	34,728	14.45%	5,018	-11.14%	(3,869)
2038	36,038	25.51%	9,193	36,038	12.64%	4,555	-12.87%	(4,638)
2039	37,412	25.42%	9,510	37,412	11.00%	4,115	-14.42%	(5,395)
2040	38,852	25.33%	9,841	38,852	9.58%	3,722	-15.75%	(6,119)
2041	40,359	25.22%	10,178	40,359	8.39%	3,386	-16.83%	(6,792)
2042	41,924	15.00%	6,289	41,924	7.32%	3,069	-7.68%	(3,220)
Total:			$191,144			$163,964		$(27,180)

TABLE IV

State Employees' Retirement System
Projected Employer Contribution Rates
Fiscal Year 2011 to 2042
($ amounts in millions)

Fiscal Year Ending June 30	House Bill 2497 as amended by Amendment 07493			House Bill 2497 as amended by Amendment 09615			Increase / (Decrease)	
	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Appropriation Payroll	Employer Contribution Rate	Employer Contribution Amount	Employer Contribution Rate	Employer Contribution Amount
2011	$5,936	5.00%	$297	$5,936	5.00%	$297	0.00%	$0
2012	6,132	8.00%	491	6,132	8.00%	491	0.00%	0
2013	6,334	11.50%	728	6,334	11.50%	728	0.00%	0
2014	6,543	16.00%	1,047	6,543	16.00%	1,047	0.00%	0
2015	6,759	20.50%	1,386	6,759	20.50%	1,386	0.00%	0
2016	6,982	22.51%	1,572	6,982	25.00%	1,746	2.49%	174
2017	7,213	22.73%	1,639	7,213	28.25%	2,037	5.52%	398
2018	7,451	22.82%	1,701	7,451	27.79%	2,071	4.97%	370
2019	7,697	22.88%	1,761	7,697	27.15%	2,090	4.27%	329
2020	7,951	22.94%	1,824	7,951	26.52%	2,109	3.58%	285
2021	8,213	22.99%	1,888	8,213	25.91%	2,128	2.92%	240
2022	8,484	23.04%	1,954	8,484	25.31%	2,148	2.27%	194
2023	8,764	23.08%	2,023	8,764	24.73%	2,168	1.65%	145
2024	9,053	23.13%	2,094	9,053	24.17%	2,188	1.04%	94
2025	9,352	23.17%	2,167	9,352	23.63%	2,210	0.46%	43
2026	9,661	23.22%	2,243	9,661	23.10%	2,232	-0.12%	(11)
2027	9,979	23.27%	2,322	9,979	22.59%	2,255	-0.68%	(67)
2028	10,309	23.31%	2,403	10,309	22.10%	2,278	-1.21%	(125)
2029	10,649	23.36%	2,487	10,649	21.62%	2,302	-1.74%	(185)
2030	11,000	23.40%	2,575	11,000	21.16%	2,327	-2.24%	(248)
2031	11,363	23.45%	2,665	11,363	20.71%	2,353	-2.74%	(312)
2032	11,738	23.50%	2,758	11,738	20.28%	2,380	-3.22%	(378)
2033	12,126	23.54%	2,855	12,126	19.86%	2,408	-3.68%	(447)
2034	12,526	23.59%	2,954	12,526	19.45%	2,436	-4.14%	(518)
2035	12,939	23.63%	3,058	12,939	19.06%	2,466	-4.57%	(592)
2036	13,366	23.68%	3,165	13,366	18.68%	2,496	-5.00%	(669)
2037	13,807	23.72%	3,276	13,807	18.31%	2,528	-5.41%	(748)
2038	14,263	23.77%	3,390	14,263	17.95%	2,560	-5.82%	(830)
2039	14,733	23.82%	3,509	14,733	17.60%	2,594	-6.22%	(915)
2040	15,220	23.86%	3,632	15,220	17.27%	2,628	-6.59%	(1,004)
2041	15,722	17.90%	2,814	15,722	13.79%	2,167	-4.11%	(647)
2042	16,241	13.43%	2,182	16,241	11.13%	1,807	-2.30%	(375)
Total:			$70,860			$65,061		$(5,799)

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

New Benefit Tiers. The bill as amended would have the effect of reducing the annual benefit accrual rate to 2.0% from 2.5% for Class T-E members of PSERS and Class A-3 members of SERS. Individuals who elect to become members of Class T-F or Class A-4 will earn a higher annual benefit accrual rate of 2.5%, but will be required to make employee contributions of 10.3% and 9.3% of payroll respectively, nominally neutralizing the additional employer costs of providing the higher benefit levels. The bill as amended would also increase the normal retirement age to age 65 for most new classes of service, increase employee contributions relative to benefits earned and increase the service requirement for vesting. The combined effect of the proposed benefit changes will be to reduce the cost to employers of providing benefits earned in the future and increase employee cost sharing.

Employee Risk Sharing. The bill as amended would require the payment of additional member contributions to the Systems, referred to as the "shared risk contribution rate," during protracted periods of unfavorable investment performance. It would appear that the goal of this provision is to require members to share in the investment risks of the retirement systems.

Purchases of Service. Under the Codes of both PSERS and SERS, active members are entitled to purchase various types of previous non-school and nonstate service on terms that generally favor the member. These subsidized service purchases generally result in small, but measurable losses to the Systems. The bill as amended would alter the service purchase calculation by requiring new members to bear the full actuarial cost, as calculated by the Systems, for most purchases of nonschool and nonstate service.

Normal Cost Calculation. PSERS and SERS use dissimilar methods for calculating the normal cost rate. Under the SERS method, the normal cost is calculated based upon the average new entrant to the System, and under the bill as amended, this method will tend to understate the System's normal cost because that cost will be based on new members earning somewhat diminished benefits. In contrast, the method employed by PSERS, which is based on a more liberal reading of the statute than the SERS interpretation, the normal cost rate reflects the average cost as a percentage of pay from entry into the System reflecting the actual class of membership of each active member. This is the traditional method for calculating the normal cost under the entry age normal actuarial cost method. Using this method, the PSERS' actuary develops a normal cost rate based on a blend of the 2.0% and 2.5% benefit accrual rates and member contribution rates of 5.25%, 6.25%, 6.5%, and 7.5%, depending on each member's date of hire and class of service. The Commission's consulting actuary has indicated that the PSERS' method would be the preferred approach for determining the normal cost for both PSERS and SERS. This is especially important if the reduced benefit classes are adopted for new members in order to avoid having a decrease in the normal cost for current members and an increase in the actuarial accrued liability. Under the PSERS' approach, the normal cost and unfunded actuarial accrued liability would not change for current members, but there would be a reduced normal cost for new members as they join the System. Thus the total normal cost of PSERS would gradually decline as new members are added and current members retire.

Potential for Additional Employer Costs. The higher member contribution rates for Class T-F and Class A-4 were specifically developed to offset, and in the aggregate, neutralize the effect of providing the higher benefit level. The analysis of the bill as amended was performed assuming that the demographics of the new members that elect Class T-F or A-4 are consistent with the demographics of new members that elect Class T-E or A-3, respectively. The actual cost of providing a choice of benefits will depend on a variety of factors, such as the extent to which adverse selection occurs, which could produce higher actual costs. When given a choice, individuals will tend to make decisions that they perceive to be in their best economic interests. In general, individual total normal costs increase as members age. Therefore, if a higher percentage of older members elect the 2.5% benefit accrual rate than do younger members, the potential exists for actual costs to exceed the additional member contributions required of Class T-F and A-4 members resulting in additional employer costs. Other factors that could contribute to additional costs include the extent to which actual plan experience differs from expected experience and the number and characteristics of the members who elect the higher benefit classes differing from the norm.

Elimination of Option 4. 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. The bill as amended would eliminate this retirement option for most new members of both Systems, resulting in an actuarial gain accruing to both Systems.

Appropriateness of Departure from Actuarial Funding Standards. The bill as amended would reduce the actuarially required contribution rate to both PSERS and SERS for several years, effectively delaying the anticipated spike in employer contribution rates projected to begin in 2013. The Commission is well aware of the fiscal challenges facing the Commonwealth resulting from the anticipated pension contribution spike. However, it must be noted that the temporary collared contribution rates proposed in the bill as amended do not follow generally accepted actuarial standards of practice. The short-term effect of the bill as amended would be to defer the payment of actuarially required contributions to both PSERS and SERS, resulting in the underfunding of both retirement Systems. The bill as amended appears to be intended to delay the anticipated contribution increases, spread those increases over many future years, but to determine contribution rates in an actuarially sound manner in the long term. The Commonwealth's policymakers must determine whether the temporary departure from actuarial funding proposed by the bill as amended is consistent with the Commonwealth's pension plan funding and fiscal management goals.

Re-amortization of Pension Liabilities. The bill as amended would require PSERS and SERS to re-amortize all of the unfunded actuarial accrued liabilities of their pension trust funds over a 24-year period in the case of PSERS and over a 30-year period in the case of SERS. The re-amortization of pension plan liabilities is a legitimate actuarial technique.

Extended Smoothing Period. For PSERS, the bill as amended would extend from five years to ten years the smoothing period applicable to the investment gains and losses of the System. The Actuarial Standards Board (ASB) is an entity within the American Academy of Actuaries (AAA) that establishes standards of practice for the actuarial profession in the United States. Actuarial Standards of Practice No. 44, *Selection and Use of Asset Valuation Methods for Pension Valuations*, requires that asset smoothing methods must recognize "*the differences from the market value of assets in a sufficiently short period*." It is the professional opinion of the Commission's consulting actuary that ten years is too long a time period over which to recognize investment gains and losses because such an extended smoothing period has the potential to produce actuarial values of assets that deviate greatly from market values of assets. While the extended smoothing period would have the advantage of delaying the recognition of unfavorable investment experience, it would also have the consequence of delaying recognition of favorable investment experience in future years. In the short-term, the extended smoothing period would serve to mitigate the negative effects of the unprecedented investment losses suffered by PSERS in 2008 by extending the period over which those investment losses are recognized.

New Employer Contribution Floor. The bill as amended would establish the employer normal cost rate as the new employer contribution floor rate for all future years following expiration of the temporary collared contribution rates. Normal cost equates to the value or "cost" of benefits accrued by active members in a given year. By mandating payment of the employer portion of the normal cost rate as the minimum contribution rate for all future years following expiration of the collared contribution rate, the bill as amended would ensure that employer contributions in future years will be adequate to fund the costs of benefits earned in that year. The bill as amended would not impact the cost of benefits already earned (accrued liability), nor would it affect the unfunded liabilities of the Systems.

COMMISSION RECOMMENDATION

On October 12, 2010, 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

A later version of House Bill Number 2497 was signed into law by the Governor on November 23, 2010.

PART II

PUBLIC EMPLOYEE RETIREMENT SYSTEM ADMINISTRATION

A. ACT 205 OF 1984.

- **2009 Filing Period**

March 31, 2010, was the deadline for the 2009 municipal pension plan reports. Of the 4,586 local governments submitting questionnaire responses, 2,042 indicated that they had established one or more pension plans. About 165 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 3, 2010. Only 27 municipalities remained delinquent as of the date of initial certification. As of December 31, 2010, one municipality remained delinquent in submitting their 2009 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 2009 Act 205 data in January 2011.

- **Act 44 of 2009**

Act 44 of 2009 was signed into law by the Governor on September 18, 2009, and makes significant changes to the Municipal Pension Plan Funding Standard and Recovery Act. The most significant for the Commission is the calculation of a distress score, based upon the aggregate funded ratio, for every municipality with a pension plan. On July 23, 2010, the Commission notified 1,439 municipalities of their distress score. Fifty-four percent of the municipalities were not distressed, but they only accounted for 18 percent of the active membership.

- **Municipal Pension Cost Certification**

In the summer of 2010, the Commission certified municipal pension cost data to the Department of the Auditor General for use in the 2010 allocation of General Municipal Pension System State Aid. In 2010, the State aid provided to municipalities to offset their employee pension costs totaled $217.9 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.

- **2010 Filing Period**

The Commission transmitted filing notices and reporting forms to the 66 counties required to submit employee pension plan reports for 2010. The reports are due by March 31, 2011.

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. 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 March 2010, and the State Employees' Retirement System in September 2010.

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

At the March 3, 2010, meeting of the Commission, the Staff presented a summary of the June 30, 2009, Actuarial Valuation Report of the Public School Employees' Retirement System (PSERS) issued January 15, 2010, and reviewed some significant facts concerning the condition of the Public School Employees' Retirement System since the prior valuation.

General Funding Information

– An increase in actuarial accrued liability from $70,941,422,000 to $75,625,850,000.
– A decrease in the actuarial value of assets from $61,017,942,000 to $59,886,689,000.
– An increase in unfunded actuarial accrued liability from $9,923,480,000 to $15,739,161,000 (total increase of $5,815,681,000).
– The unfunded accrued liability was $4,550,216,000 more than expected.
– A reduction in the investment return assumption from 8.25% to 8.0%.
– A 6.8% decrease in the funded ratio from 86.0% to 79.2%.
– An increase in employer contributions for pensions of 3.58% (plus a 0.64% to the health insurance contribution rate).
– Employer contributions for pension benefits are 3.58% above the statutory 4.00% minimum employer contribution rate, plus the 0.64% health insurance contribution rate for a total employer contribution rate of 8.22%.
– An increase in the total normal cost from 14.67% to 15.42%.

Changes in Contribution Rate

		Employer Contributions			
Fiscal Year	Member Contributions	Normal Cost	Unfunded Accrued Liability	Health Insurance	Total
2010/2011	7.34%	8.08%	(0.50)%	.64%	8.22%
2009/2010	7.32%	7.35%	(3.72)%	.78%	4.78%
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%

Reasons for Change in the Contribution Rate

– Fiscal Year 2009/2010 rate after adjustment for pension floor	4.78 %
– Adjustment due to effect of 4% floor on Fiscal Year 2010 pension contribution	(0.37)
– Fiscal Year 2009/2010 rate prior to adjustment for pension floor	4.41 %
– Increase due to change in normal rate	0.00
– Decrease due to payroll growth and liability experience	(0.03)
– Increase due to actuarial loss on assets	2.04
– Increase due to change in interest rate from 8.25% to 8.00%	1.94
– Decrease due to change in health insurance contribution rate	(0.14)
Total Fiscal Year 2010/2011 Employer rate	8.22 %

Reasons for Change Greater Than Expected in Unfunded Actuarial Accrued Liability

• Experience (Gains) Losses	
– Loss from investment return on actuarial value of assets	$2,800,622,000
– Gain from salary increases less than expected	(225,166,000)
– Loss from new entrants and pickups	310,489,000
– Gain from termination experience (retirement/disability/termination)	(71,915,000)
– Gain from non-vested termination experience	(215,117,000)
– Loss from data/miscellaneous	75,133,000
– Loss from mortality experience	90,538,000
Sub-Total:	$2,764,584,000
• Change in assumption	$1,785,632,000
Grand Total:	$4,550,216,000

* * * * * * * * * *

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, 2009

The following is a summary of the June 30, 2009, Actuarial Valuation of the Public School Employees' Retirement System and a comparison of the 2009 results with those of 2008.

	6/30/08		6/30/09	
Membership				
Active Members	272,690		279,701	
Inactive and Vested Members	100,803		103,805	
Retired Members	157,656		162,206	
Disabled Members	7,435		7,713	
Survivors and Beneficiaries	8,449		8,044	
Payroll and Annuities Payable				
Total Annual Payroll	$11,921,469,000		$12,524,593,000	
Annual Annuities and Benefits	$ 3,811,499,000		$ 3,996,288,000	
Valuation Data				
Accrued Liability [1]	$70,941,422,000		$75,625,850,000	
Actuarial Value of Assets	61,017,942,000		59,886,689,000	
Unfunded Accrued Liability [1]	$ 9,923,480,000		$15,739,161,000	
Fund Ratio (Pensions and Health Insurance Combined)	86.0%		79.2%	
Funding Costs				
Total Normal Cost	$1,748,879,500	14.67 %	$1,931,292,200	15.42 %
Amortization [2]	(479,579,000)	(3.72)%	(67,748,000)	(0.50)%
Full Actuarial Funding	$1,269,300,500	10.95 %	$1,863,544,200	14.92 %
Support				
Member	$ 872,651,530.80	7.32%	$ 919,305,126	7.34%
Employer	569,846,218.20	4.78%	1,029,521,544	8.22% [3]
Total Support	$1,442,497,749.00	12.10%	$1,948,826,670	15.56%

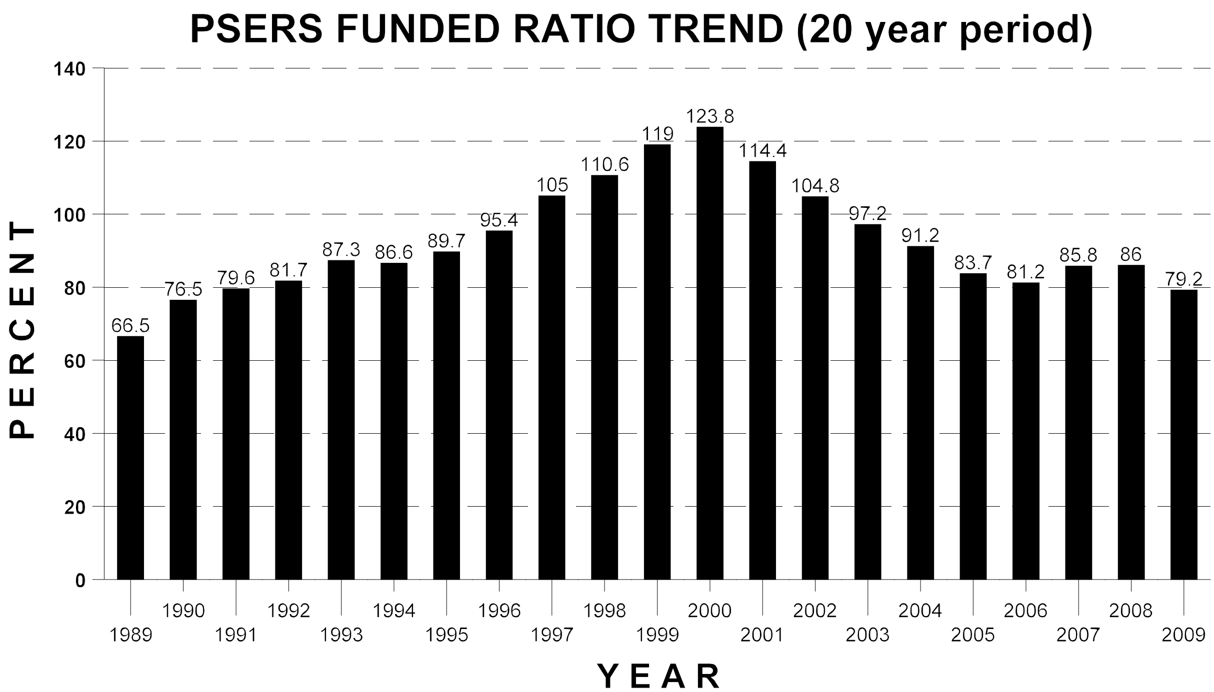
[1] Includes liability for health care payments.

[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.

Note: Amortization payments calculated based upon projected employer payroll.

[3] Under the PSERS Code, the employer and the Commonwealth share the cost of required contributions. The current process requires "school entities" as defined in the Code (school districts, intermediate units, and area vocational technical schools) to initially pay the entire amount of the required employer contributions. The Commonwealth then reimburses school entities with an amount that is not less than 50% of the aggregate employer contribution rate. (The actual amount is determined through a formula known as the "Market Value Income Aid Ratio" as defined in section 2501(14.1) of the Public School Code of 1949, which is also used in calculating other reimbursements by the Commonwealth and between school districts.) The current statewide average is roughly a 52%/48% ratio, with the Commonwealth paying 52%. All other PSERS employers that are not school entities currently pay one-half of the employer contribution rate, with the Commonwealth contributing the remaining one-half. Examples of PSERS employers that are not "school entities" as defined in the PSERS Code include the colleges and universities under the State System of Higher Education, community colleges, various schools for the blind and deaf, charter schools and miscellaneous other employers.

The employer health-care contribution rate of 0.64% for Fiscal Year 2010-2011 is included in this total.


PSERS FUNDED RATIO TREND (20 year period)
PERCENT
0
20
40
60
80
100
120
140
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
86
79.2
1989
1990
1991
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2007
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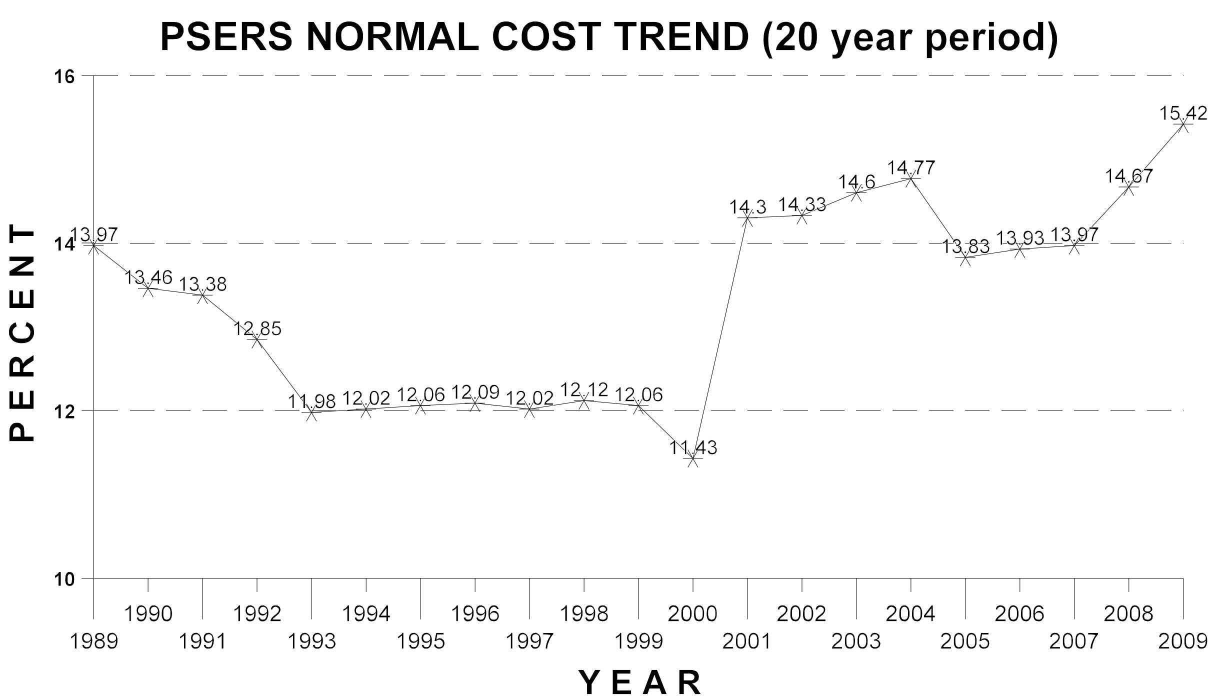
2009
YEAR


PSERS NORMAL COST TREND (20 year period)
PERCENT
10
12
14
16
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
14.67
15.42
1989
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YEAR

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

At the September 9, 2010, meeting of the Commission, the Staff presented a summary of the December 31, 2009, Actuarial Valuation Report of the State Employees' Retirement System (SERS) issued June 9, 2010, 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 46 of 2010) is 5.00 percent. The December 31, 2009, contribution before Act 46 would have been 5.64 percent.

Summary of Changes

- Changes in the December 31, 2009, valuation:

	Normal Cost	Unfunded Liability	Total
– Loss from investment earnings		1.67%	1.67%
– Other differences		- 0.07%	- 0.07%
– Pay increases different than assumptions		0.13%	0.13%
– Change in demographics of new entrants	0.02%	- 0.02%	0.00%
– Change in amortization due to change in payroll	0.00%	0.28%	0.28%
– Total Change	0.02%	1.99%	2.01%

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

– Loss from investment earnings	$1,118,035,482
– Other differences	(37,288,836)
– Pay increases different than assumptions	84,681,278
– Change in demographics of new entrants	(11,597,359)
– Total Change	$1,153,830,565
December 31, 2009, Unfunded Liability	$5,592,323,524

Employer Normal Cost Rate

- Normal Cost Rate for New Active Members:

– Superannuation and Withdrawal	13.55%
– Disability	1.26%
– Death	0.60%
– Refunds	0.37%
– Total	15.78%
– Member Contributions	6.25%
– Employer Normal Cost	9.53%

* * * * * * * * * *

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, 2009

The following is a summary of the December 31, 2009, Actuarial Valuation of the State Employees' Retirement System and a comparison of the 2009 results with those of 2008.

	12/31/08		12/31/09	
Membership				
Active	110,866		110,107	
Inactive	6,009		6,190	
Retired	90,890		92,102	
Disabled	7,602		7,674	
Survivors and Beneficiaries	9,654		9,863	
Payroll and Annuities Payable				
Total Annual Funding Payroll	$5,660,319,000		$5,935,988,000	
Annual Annuities and Benefits	$1,908,350,821		$1,987,987,717	
Valuation Data				
Accrued Liability	$34,437,396,113		$35,797,016,636	
Assets [1]	30,635,620,922		30,204,693,112	
Unfunded Accrued Liability	$ 3,801,775,191		$ 5,592,323,524	
Funded Ratio [2]	89.0%		84.4%	
Funding Costs [3]				
Normal Cost [4]	$ 538,296,336.9	9.51 %	$ 565,699,656.4	9.53 %
Amortization [5]	$(332,826,757.2)	(5.88)%	$(230,909,933.2)	(3.89)%
Actuarial Funding	$ 205,469,579.7	3.63 %	$ 334,789,723.2	5.64 %
Support [3]				
Member	$353,769,937.5	6.25%	$370,999,250.0	6.25%
Commonwealth [6]	$226,412,760.0	4.00%	$296,799,400.0	5.00%
Total Support	$580,182,697.5	10.25%	$667,798,650.0	11.25%
Total Commonwealth Contribution [7]	$226,978,791.9	4.01%	$297,392,998.8	5.01%

EXPLANATORY FOOTNOTES

[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] Due to rounding, the dollar figures shown here differ slightly from those shown in the Actuarial Reports.

[4] 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.

[5] 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 (i) over a ten-year period beginning July 1, 2002, for COLAs before 2002 and (ii) over ten-year periods from the July 1 following enactment of the increase for COLAs after 2001. All other changes in liability are being funded over thirty-year periods from the July 1 following the valuation that determined the change.

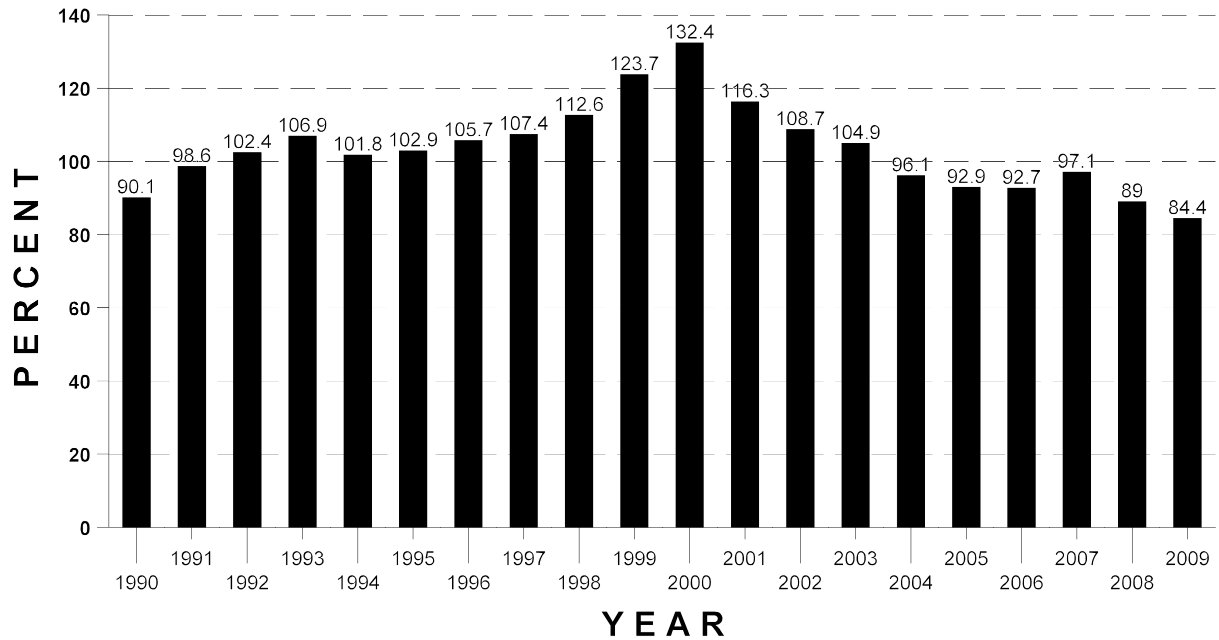
[6] On July 6, 2010, Governor Rendell signed into law Act 2010-46 (previously Senate Bill No. 1042, as amended, P. N. 2141), which established (in Section 1702-N of the Fiscal Code) that the FY 2010-11 composite rate (expressed as a percentage of payroll) for employer funding of SERS shall be 1% greater than the composite rate of 4.00% that applied for FY 2009-10. This occurred just one month after Hay Group's issuance of the SERS 2009 Actuarial Report, reflecting the results of the December 31, 2009, actuarial valuation. Therefore, both the valuation and the report were based upon the SERS Code, under which the FY 2010-11 composite employer contribution rate was the actuarially determined rate of 5.64 percent of payroll.

Under Act 2010-46, the new composite employer contribution rate of 5.00 percent of payroll became effective beginning July 1, 2010, superseding the 5.64 percent of payroll employer contribution rate previously determined in the December 31, 2009, actuarial valuation and communicated in the 2009 Actuarial Report. This change necessitated a redetermination of the employer contribution rates by Hay Group for the fiscal year beginning July 1, 2010, which had been previously provided on Page 2 of the 2009 Actuarial Report. Hay Group recalculated these rates and communicated the new rates to SERS in a letter to Executive Director Leonard Knepp issued on July 7, 2010.

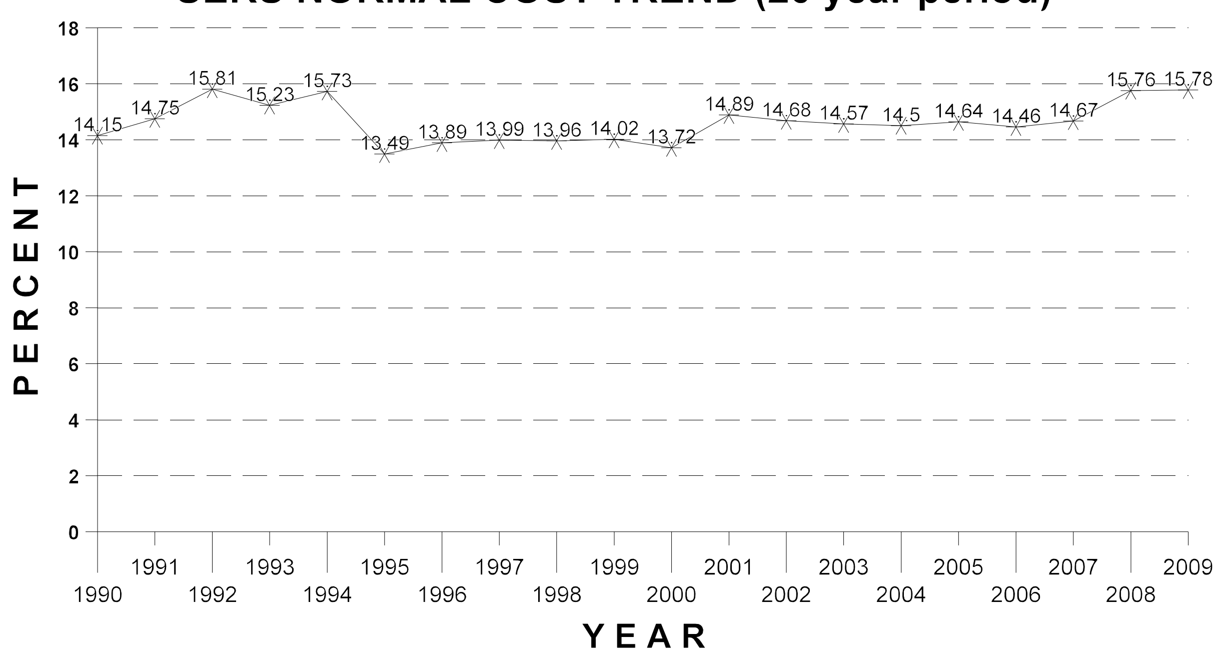
The enactment of Act 2010-46 also required changes to several other schedules included in the original 2009 Actuarial Report. With the concurrence of SERS, Hay Group prepared a supplemental report to provide replacement schedules for those included in the original report that were affected by Act 2010-46. Pages 1-7 of the Supplement supersede pages 1, 2, 12, 13, 14, 26 and 27, respectively, of the 2009 Actuarial Report. All other pages and schedules of the 2009 Actuarial Report remain valid supporting documentation for the December 31, 2009, actuarial valuation. The summary prepared by the Commission staff reflects all changes made necessary by the enactment of Act 2010-46.

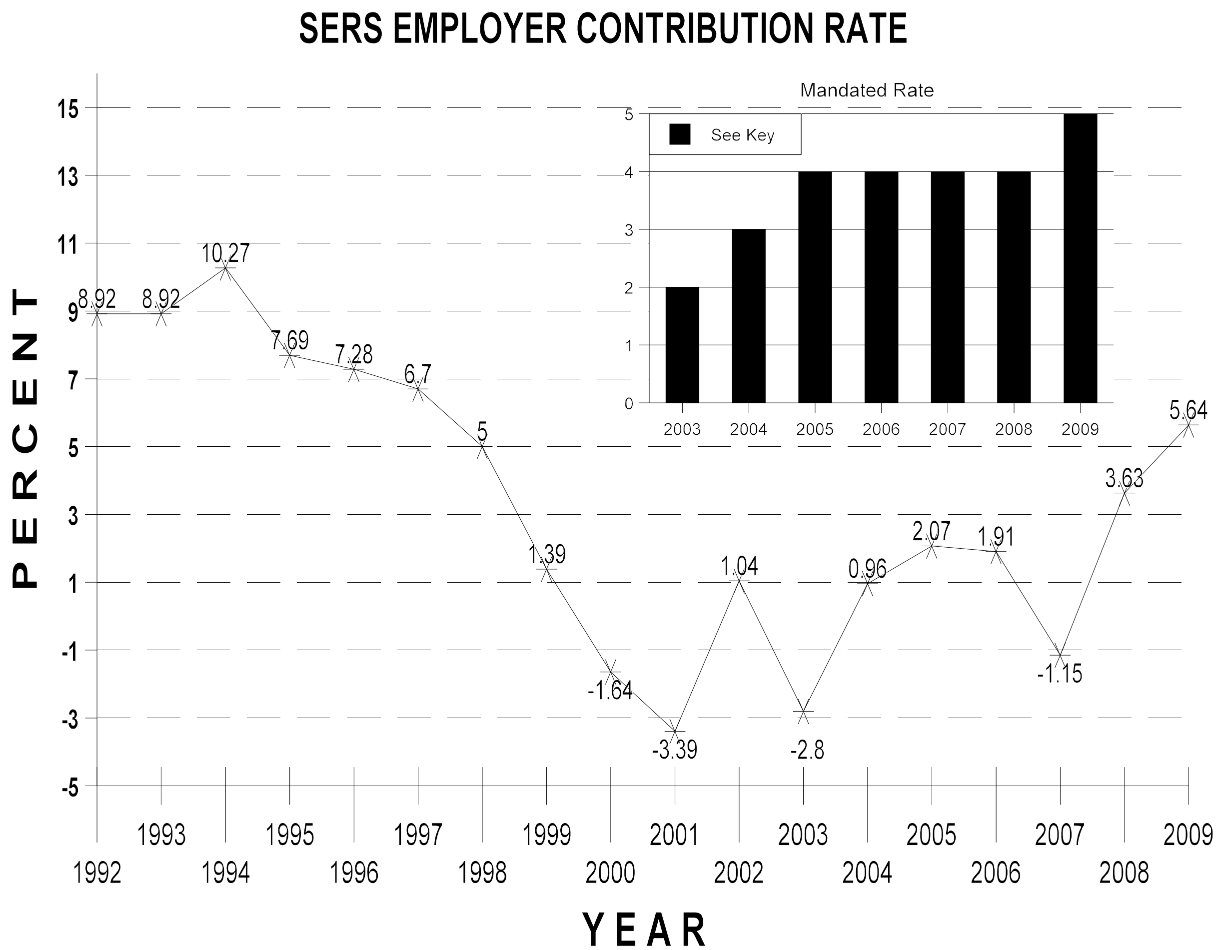
[7] The total Commonwealth support contribution for the SERS plan includes a .01% contribution for the Benefits Completion Plan.

SERS FUNDED RATIO TREND (20 year period)



SERS NORMAL COST TREND (20 year period)





Key (Commonwealth Mandated Contribution)

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.
5.00 percent mandated contribution per Act 46 of 2010.

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 2010 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. Craig Lehman
COUNTY COMMISSIONERS ASSOCIATION OF PENNSYLVANIA

Mr. Douglas E. Bilheimer
PENNSYLVANIA MUNICIPAL AUTHORITIES ASSOCIATION

MUNICIPAL EMPLOYEE PENSION ADVISORY COMMITTEE

Mr. Art Martynuska
PENNSYLVANIA PROFESSIONAL FIRE FIGHTERS' ASSOCIATION

Mr. Richard Costello
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. Steven R. Nickol
PENNSYLVANIA STATE EDUCATION ASSOCIATION

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 2010 were:

Conrad Siegel Actuaries
Mr. David H. Killick

Milliman
Ms. Katherine A. Warren
Mr. Timothy J. Nugent

Cheiron, Inc.
Mr. Kenneth A. Kent

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 D

PUBLIC EMPLOYEE RETIREMENT COMMISSION

COMPREHENSIVE LIST OF 2009 – 2010 SESSIONS LEGISLATION REGARDING PUBLIC EMPLOYEE RETIREMENT ISSUES AS OF DECEMBER 31, 2010

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
H. B. 7 P. N. 634 (McCall)	PSERS, permitting an active member to purchase up to two years of nonschool service credit for time spent on a maternity leave of absence after November 1, 1978.	Introduced and referred to House Education Committee	02/24/09
H. B. 9 P. N. 3939 (McCall)	Pennsylvania Conservation Corps Act (Act 112 of 1984), to provide for the expiration of the Act and the Pennsylvania Conservation Corps on June 30, 2020.	Introduced and referred to House State Government Committee	03/03/09
		Reported as amended	06/17/09
		First Consideration	06/17/09
		Re-referred to House Rules Committee	06/17/09
		Re-referred to House Appropriations Committee	09/11/09
		Actuarial Note (P. N. 2205)	03/03/10
		Reported as amended	03/15/10
		Commission Letter (P. N. 3360)	03/16/10
		Second Consideration	03/17/10
		Third Consideration and Final Passage (142-54)	03/22/10
		Referred to Senate Labor & Industry Committee	03/29/10
		Reported as amended	04/13/10
		First Consideration	04/13/10
		Re-referred to Senate Appropriations Committee	06/16/10
		Reported as amended	06/21/10
		Second Consideration	06/22/10
		Third Consideration and Final Passage (48-0)	06/28/10
		Signed by the Governor (Act 37 of 2010)	06/29/10
H. B. 18 P. N. 4121 (Wagner)	PMRS, amends the Pennsylvania Municipal Retirement Law (Act 15 of 1974) to permit a retired municipal police officer to return to part-time duty, or as a substitute officer, for up to 800 hours per calendar year without losing retirement benefits.	Introduced and referred to House Finance Committee	08/02/10
H. B. 30 P. N. 514 (Daley)	PSERS, permits active members of PSERS to retire during the period of March 1, 2009, through June 1, 2009, with 30 years of service, or with a combination of years of service and age that when added together total 80, without the member's annuity being reduced on account of a retirement age that is under superannuation age. The bill would entitle an eligible member to any insurance	Introduced and referred to House State Government Committee	02/18/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	coverage under any contract of insurance affecting the member that is in effect on the member's effective date of retirement. The bill would also temporarily require that 60% of the "net savings cost" realized from the replacement of retiring members be deducted from the required reimbursement to each school district and be transmitted to the Public School Employees' Retirement Fund.		
H. B. 31 P. N. 515 (Daley)	SERS, permits an active member of SERS to retire during the period of March 1, 2009, through June 1, 2009, with 30 years of service, or with a combination of years of service and age that when added together total 80, without the member's annuity being reduced on account of a retirement age that is under superannuation age. The bill would entitle an eligible member to any insurance coverage under any contract of insurance affecting the member that is in effect on the member's effective date of retirement. The bill would also temporarily require that 60% of the "net savings cost" realized from the replacement of retiring members be deducted from the required reimbursement to each agency and be transmitted to the State Employees' Retirement Fund.	Introduced and referred to House State Government Committee	02/18/09
H. B. 32 P. N. 1726 (Daley)	PSERS and SERS, providing a permanent supplemental annuity equal to the increase in the Consumer Price Index for All Urban Consumers, up to 3%, for all active members who elect to contribute an additional 1% of annual salary.	Introduced and referred to House Education Committee	05/04/09
H. B. 103 P. N. 96 (O'Brien)	Cities of the First Class (Philadelphia) or Second Class (Pittsburgh), an act prohibiting a city of the first or second class from denying pension and pension related benefits to the surviving spouse of a deceased firefighter or fire department employee due to the remarriage of the surviving spouse.	Introduced and referred to House Finance Committee **Actuarial Note (P. N. 96)**	01/28/09 03/19/09
H. B. 129 P. N. 125 (Killion)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), providing for the establishment and administration of deferred retirement option plans (DROPs) in local governments. The bill creates the Deferred Retirement Option Plans Law, which provides for a deferred retirement option plan under which an eligible member of the local government's retirement system may elect to participate in a DROP, defer receipt of retirement system benefits and	Introduced and referred to House Local Government Committee **Actuarial Note (P. N. 125)**	01/30/09 03/19/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	continue employment with the local government.		
H. B. 150 P. N. 146 (Solobay)	Title 71 (State Government), defining "Commonwealth firefighter or firefighter instructor" and providing age 50 superannuation retirement benefits to certain Commonwealth firefighters or firefighter instructors.	Introduced and referred to House Finance Committee	01/30/09
H. B. 336 P. N. 367 (Baker)	Pennsylvania Conservation Corps Act (Act 112 of 1984), beginning July 1, 2009, mandating membership in SERS for Pennsylvania Conservation Corps "crewleaders," and authorizing the provision of state healthcare benefits for crewleaders.	Introduced and referred to House State Government Committee	02/10/09
H. B. 337 P. N. 368 (Baker)	PSERS and SERS, beginning January 1, 2010, providing for optional membership in the system for crewleaders employed pursuant the PA Conservation Corps Act (Act 112 of 1984), and providing for the purchase of up to five years of nonschool or nonstate service credit for previous service as a crewleader with the PA Conservation Corps rendered prior to January 1, 2010, providing the member elects to purchase the service within three years of becoming eligible to do so, that the member pays the full actuarial cost of the benefit enhancement, and that the member is prohibited from withdrawing contributions for the service purchase under Option 4.	Introduced and referred to House State Government Committee	02/10/09
H. B. 408 P. N. 452 (Hutchinson)	PSERS, permitting active members to purchase up to three years of creditable nonschool service for work experience used by the member to obtain certification as a vocational teacher.	Introduced and referred to House Finance Committee	02/13/09
H. B. 498 P. N. 550 (Reed)	PSERS and SERS, mandating payment of a 5% annual COLA to eligible annuitants of both systems for a period of five years, provided that the actuaries of the respective systems certify that sufficient reserves exist in the funds of the systems to allow for the payment of the COLAs without the need for increases in employer contributions and without any added cost to the taxpayers of the Commonwealth.	Introduced and referred to House Finance Committee	02/18/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
H. B. 555 P. N. 604 (Beyer)	PSERS, amending Section 8346 (Termination of Annuities) of the Code by placing certain compensation, managerial and administrative mandates on school employers that employ PSERS annuitants under the emergency return to service provisions of the PSERS Code.	Introduced and referred to House Education Committee	02/23/09
H. B. 566 P. N. 674 (Smith)	Second Class County Code, amending the definition of "compensation" to exclude overtime pay from the calculation of a member's retirement benefit; further providing for membership of the Allegheny County Retirement Board; and further providing for the calculation of retirement allowances.	Introduced and referred to House Finance Committee	02/26/09
H. B. 610 P. N. 2024 (Kauffman)	SERS, defining "campus police officer" and providing age 50 superannuation retirement benefits to certain campus police officers.	Introduced and referred to House State Government Committee Corrective reprint (P. N. 2024)	02/24/09 06/08/09
H. B. 632 P. N. 691 (Dally)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding that forfeited benefits shall be calculated from the date of initial arraignment.	Introduced and referred to House Finance Committee	02/26/09
H. B. 679 P. N. 752 (Reed)	SERS, defining "campus police officer" and providing age 50 superannuation retirement benefits to certain campus police officers.	Introduced and referred to House State Government Committee **Advisory Note (P. N. 752)**	03/03/09 07/09/09
H. B. 783 P. N. 872 (Creighton)	SERS, establishing an alternative defined contribution retirement program for members of the General Assembly.	Introduced and referred to House Finance Committee	03/06/09
H. B. 818 P. N. 925 (Haluska)	SERS, authorizing the purchase of nonstate service credit for certain previous employment in the mining industry.	Introduced and referred to House Finance Committee	03/10/09
H. B. 885 P. N. 1004 (Benninghoff)	SERS, amending the Code to permit an annuitant to return to State service as a certified instructor in the Municipal Police Officers' Education and Training Program without cessation of annuity.	Introduced and referred to House Finance Committee	03/12/09
H. B. 888 P. N. 1007 (Benninghoff)	PSERS and SERS, mandating payment of automatic, annual cost-of-living adjustments to annuitants of both systems beginning with the first monthly annuity beginning July 1, 2009 and annually thereafter. The amount of the COLA shall be calculated at one-half of the change in the CPI for the preceding 12-month period.	Introduced and referred to House Finance Committee	03/12/09
H. B. 902 P. N. 1021 (Denlinger)	SERS, permitting the purchase of up to five years of nonstate service credit for previous service as a municipal police officer.	Introduced and referred to House Finance Committee	03/12/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
H. B. 949 P. N. 1087 (Mann)	SERS, permitting certain employees of the State System of Higher Education who are currently members of an independent retirement program to elect membership in SERS.	Introduced and referred to House Finance Committee	03/17/09
H. B. 1039 P. N. 1210 (Moul)	PMRS, amends the disability retirement eligibility requirements for police officers and firefighters from being unable to engage in any gainful employment to being unable to perform the duties of that office.	Introduced and referred to House Finance Committee **Actuarial Note (P. N. 1210)**	03/23/09 06/18/09
H. B. 1061 P. N. 1243 (Schroder)	SERS, establishing a mandatory defined contribution retirement program for persons who become members of the General Assembly after December 1, 2010, or who are re-elected to serve as a member of the General Assembly beginning on or after December 1, 2010. Matching employer contributions shall not exceed 4% of the member's compensation, while members can contribute to the program to the extent permitted by law.	Introduced and referred to House Finance Committee	03/24/09
H. B. 1120 P. N. 1323 (Freeman)	SERS, permitting an active member who was formerly an active member of PSERS and whose service credit in PSERS has not been converted to service credited in another public pension plan in PA to elect to become a multiple service member on or before December 31, 2010.	Introduced and referred to House Finance Committee	03/26/09
H. B. 1132 P. N. 1344 (Dally)	PMRS, liberalizing the service purchase eligibility criteria for military service by removing language in the Law which currently requires the service to be purchased to have occurred during a time of war, armed conflict or national emergency proclaimed by the President of the United States.	Introduced and referred to House Finance Committee **Actuarial Note (P. N. 1344)**	03/27/09 06/18/09
H. B. 1174 P. N. 1403 (Boyd)	An act, effective November 30, 2009, establishing a "unified contribution pension plan," which is a defined contribution retirement plan applicable to all public employees (hired on or after November 30, 2009) of all public employers within the Commonwealth, including state, school, municipal, county and all other employers of a governmental or quasi-governmental nature.	Introduced and referred to House Finance Committee	04/03/09
H. B. 1179 P. N. 1408 (Casorio)	Municipal Police Pension Law (Act 600), amending section 3 of the Act by reducing the minimum service requirement for normal retirement eligibility from 25 to 20 years, and eliminating the age requirement for normal retirement eligibility.	Introduced and referred to House Finance Committee	04/03/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
H. B. 1180 P. N. 1409 (Casorio)	Municipal Police Pension Law (Act 600 of 1955), increasing the maximum benefit that may be paid to the surviving spouse or child of a member who dies while in service or on retirement from not less than 50% to not less than 60% of the pension benefit that was or would have been payable to the member at the time of death, reducing the time period over which a member's pension benefit is calculated from the last 36 to the last 24 months of employment, increasing the maximum service increment from $500 to $600 monthly, and increasing the limit on the maximum pension benefit, including COLAs, from 75% to 80% of salary.	Introduced and referred to House Finance Committee	04/03/09
H. B. 1182 P. N. 1830 (Casorio)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending listed offenses to include offenses related to contraband and institutional sexual assault.	Introduced and referred to House Judiciary Committee First Consideration Re-referred to House Appropriations Committee Floor amendment adopted Second Consideration Third Consideration and Final Passage (191-0) Referred to Senate Finance Committee First Consideration Re-referred to Senate Appropriations Committee	04/03/09 05/05/09 05/06/09 05/11/09 05/11/09 06/01/09 06/04/09 06/17/09 06/25/09
H. B. 1246 P. N. 1479 (Harper)	Emergency and Law Enforcement Personnel Death Benefits Act (Act 101 of 1976) amends the act to 1) mandate payment of a killed-in-service death benefit to the surviving spouse or, if there is no surviving spouse, the minor child, of a paid firefighter, ambulance service or rescue squad member, or law enforcement officer in an amount equal to the decedent's monthly salary (adjusted annually by an amount equal to the increase in the Consumer Price Index), less the amount of any workers' compensation or pension benefit payable to an eligible beneficiary; 2) repeal Section 5(e)(2) of the Municipal Police Pension Law (Act 600 of 1955) which currently provides the killed-in-service death benefit applicable only to members of Act 600 pension plans; and 3) repeal Sections 202(b)(3)(vi) and (4)(vi) of the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) which provides for a special extended amortization period applicable to the funding of liabilities resulting from the	Introduced and referred to House Finance Committee **Actuarial Note (P. N. 1479)**	04/13/09 04/24/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	payment of the Act 600 killed-in-service benefit.		
H. B. 1269 P. N. 1504 (Dally)	Municipal Police Pension Law (Act 600 of 1955), permitting members to purchase service credit for up to five years of previous part-time service.	Introduced and referred to House Finance Committee	04/16/09
H. B. 1277 P. N. 1511 (Dally)	PSERS, permitting an active member of the system to purchase up to five years of nonschool service credit for previous service as a school employee, teacher or instructor in an accredited Pennsylvania nonpublic elementary or secondary school, provided the member was entitled to a provisional or professional certificate to teach in the public schools of the Commonwealth at the time the nonschool service was rendered	Introduced and referred to House Finance Committee	04/16/09
H. B. 1315 P. N. 1566 (Boback)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending listed offenses to include offenses related to theft by unlawful taking or disposition.	Introduced and referred to House Finance Committee	04/21/09
H. B. 1412 P. N. 1734 (Daley)	PSERS, amends section 8302 of the Code to permit an eligible member to receive more than one year of credited service for any consecutive 12-month period if the member is contributing to the fund as both a full-time and part-time salaried employee.	Introduced and referred to House Education Committee	05/04/09
H. B. 1419 P. N. 1741 (Evans, D.)	PSERS, making an appropriation from the Public School Employees' Retirement Fund in the amount of $43,227,000, to provide for expenses of the Public School Employees' Retirement Board for the fiscal year beginning July 1, 2009.	Introduced and referred to House Appropriations Committee	05/04/09
		First Consideration	06/16/09
		Re-referred to House Rules Committee	06/16/09
		Re-referred to House Appropriations Committee	06/17/09
		Second Consideration	08/03/09
		Third Consideration and Final Passage (197-0)	08/05/09
		Referred to Senate Appropriations Committee	08/05/09
		First Consideration	08/10/09
		Second Consideration	08/11/09
		Third Consideration and Final Passage (46-0)	08/12/09
		Signed by the Governor (Act 2A of 2009)	08/12/09
H. B. 1420 P. N. 1742 (Evans, D.)	SERS, making an appropriation from the State Employees' Retirement Fund in the amount of $27,733,000, to provide for expenses of the State Employees' Retirement Board for the fiscal year beginning July 1, 2009.	Introduced and referred to House Appropriations Committee	05/04/09
		First Consideration	06/16/09
		Re-referred to House Rules Committee	06/16/09
		Re-referred to House Appropriations Committee	06/17/09
		Second Consideration	08/03/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
		Third Consideration and Final Passage (197-0)	08/05/09
		Referred to Senate Appropriations Committee	08/05/09
		First Consideration	08/10/09
		Second Consideration	08/11/09
		Third Consideration and Final Passage (46-0)	08/12/09
		Signed by the Governor (Act 3A of 2009)	08/12/09
H. B. 1428 P. N. 4372 (Goodman)	PSERS, further providing for membership of the PSERS Board.	Introduced and referred to House Finance Committee	05/04/09
		Reported as amended	09/28/10
		First Consideration	09/28/10
		Re-referred to House Appropriations Committee	09/28/10
H. B. 1432 P. N. 1762 (Cutler)	PSERS and SERS, amending the Codes of both systems by limiting the amount of a maximum single life annuity to an amount not to exceed the highest compensation received during any period of 12 consecutive months.	Introduced and referred to House Finance Committee	05/05/09
H. B. 1451 P. N. 1796 (Benninghoff)	SERS, amending the Code to permit an annuitant to return to State service as a certified instructor in the Municipal Police Officers' Education and Training Program without cessation of annuity.	Introduced and referred to House Finance Committee	05/07/09
H. B. 1467 P. N. 1819 (Clymer)	PSERS and SERS, increasing and expanding the employer contribution floor rates provided for in the Codes of the Systems.	Introduced and referred to House Finance Committee	05/08/09
H. B. 1479 P. N. 1841 (Mann)	PSERS and SERS, amending the Codes of both Systems by mandating that non-intervening military service be credited as Class T-D or Class AA (2.5% accrual rate) instead of Class T-C or Class A (2.0% accrual rate).	Introduced and referred to House Finance Committee	05/12/09
H. B. 1511 P. N. 1878 (Harkins)	Act 362 of 1945, providing members of any third class city's retirement system a post retirement adjustment; provided the provisions of the Municipal Pension Plan Funding Standard and Recovery Act (Act 205) have been satisfied, the city council shall approve the increase subject to the approval of the board.	Introduced and referred to Urban Affairs Committee	05/26/09
H. B. 1556 P. N. 1931 (Gibbons)	PSERS and SERS, providing a supplemental annuity (COLA) to eligible annuitants, commencing with the first monthly annuity payment after July 1, 2009, with percentage increases ranging from 20% to 100%, depending upon the member's date of retirement and paid over a five-year period. An eligible annui-	Introduced and referred to House Finance Committee	05/29/09

	tant is defined as any superannuation, withdrawal or disability annuitant who is receiving an annuity on July 1, 2009, and whose most recent effective date of retirement is prior to July 1, 2001. Annuitants with creditable service in Class T-D, Class D-4 or Class AA service would not be eligible to receive the supplemental annuity.		
H. B. 1583 P. N. 1985 (Miller)	PSERS, increasing and expanding the employer contribution floor rate provided for in the PSERS Code.	Introduced and referred to House Finance Committee	06/03/09
H. B. 1612 P. N. 2010 (Petri)	PSERS, amending the Code to establish an optional defined contribution plan to be known as the Public School Employee's Optional Retirement Program effective January 1, 2009.	Introduced and referred to House Finance Committee	06/05/09
H. B. 1613 P. N. 2011 (Petri)	SERS, amending the Code to establish an optional defined contribution plan to be known as the State Employees' Optional Retirement Program effective July 1, 2009.	Introduced and referred to House Finance Committee	06/05/09
H. B. 1821 P. N. 2968 (Shapiro)	An Act, creating the Protecting Pennsylvania's Investments Act, requiring divestment of investment holdings in certain entities with business ties to the nations of Iran and Sudan and mandating the reimbursement of the affected public funds for investment losses incurred as a result of compliance with the bill's divestiture provisions by the Commonwealth from the General Fund.	Introduced and referred to House State Government Committee	07/02/09
		Reported as amended	07/14/09
		First Consideration	07/14/09
		Re-referred to House Rules Committee	07/14/09
		Re-referred to House Appropriations Committee	09/11/09
		Commission Letter (A. 02822, 02830 & 03707)	11/13/09
		Commission Letter (P. N. 2447)	11/13/09
		Second Consideration	11/17/09
		Third Consideration and Final Passage (193-0)	12/07/09
		Referred to Senate Finance Committee	12/14/09
H. B. 1828 P. N. 2638 (Williams, J.)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205), the bill would amend the Act to: 1) Permit, but not require, county pension plans to use any reasonable actuarial assumptions or methodologies provided for in Act 205; 2) Mandate revised amortization schedules applicable to all future unfunded actuarial accrued liabilities incurred by municipal pension plans; 3) Provide for optional, alternative, expanded asset smoothing methods for determination of the actuarial value of assets; 4) Establish a new distress determination method using the pension plan ratio of assets to liabilities, based upon the most recent actuarial valuation report; 5) Es-	Introduced and referred to House Appropriations Committee	07/03/09
		First Consideration	07/06/09
		Re-referred to House Rules Committee	07/06/09
		Re-referred to House Appropriations Committee	07/07/09
		Actuarial Note (P. N. 2384)	07/15/09
		Reported as amended	07/30/09
		Commission Letter (P. N. 2521)	07/31/09
		Second Consideration	08/04/09
		Third Consideration and Final Passage (112-85)	08/05/09
		Referred to Senate Finance Committee	08/05/09
		Reported as amended	08/24/09
		First Consideration	08/24/09

tablish three new levels of distress (Level I - minimal, Level II - moderate and Level III - severe) with corresponding voluntary and mandatory remedies dependent upon the severity of distress; 6) Clarify the limitations on the uses of the special municipal taxing authority currently provided under the Act, and in the case of a municipality utilizing the proceeds from the special tax to fund other post-employment benefits (OPEBs), require the inclusion of OPEB liabilities in the actuarial valuation report filed with the Commission and in the calculation of the municipality's Minimum Municipal Obligation (MMO); 7) Establish conduct and disclosure standards for professional service contracts, requiring municipal pension systems to adopt procedures to advertise and review proposals for contracts for professional services; 8) Exempt the City of Philadelphia from the mandatory provisions of the new Act 205 recovery program until January 1, 2016; 9) Permit, but not require the City of Philadelphia to re-amortize all of the unfunded actuarial accrued liabilities in the city's pension plans over a 30-year period using level-dollar amortization payments; 10) Over a multi-year period, permit the city of Philadelphia to defer payment of a portion of the city's Minimum Municipal Obligation (MMO) and mandating a repayment schedule applicable to any amounts deferred; 11) Permit the City of Philadelphia to temporarily impose a local sales and use tax of 1%, with any moneys received from the sales and use tax being used only to pay the city's MMO; 12) Require the City of Philadelphia to comply with certain provisions of the bill, with failure to comply resulting in the withholding of certain state grants, loans and entitlements in an amount equal to the deferral amount not repaid; 13) Permit the City of Pittsburgh to impose a parking tax of 37.5%, with 6.75% of any moneys received from the parking tax being used only to pay the city's MMO; 14) Permit the City of Pittsburgh to impose an additional 2.5% parking tax if the city sells or leases any of its parking garages with net proceeds to be deposited with the Pennsylvania Municipal Retirement System (PMRS) on behalf of the city; 15) Mandate the transfer of administration of the City of Pittsburgh's pension plans to PMRS if the

Concise Status and History	Date
Second Consideration	08/25/09
Re-referred to Senate Appropriations Committee	08/26/09
Amended on Third Consideration	08/26/09
Third Consideration and Final Passage (38-9)	08/26/09
Referred to House Rules Committee	08/27/09
Commission Letter (P. N. 2609)	09/02/09
Reported as amended	09/10/09
House concurred in Senate amendments, as amended by the House (113-76)	09/11/09
Commission Letter (A. 03619)	09/11/09
Commission Letter (A. 03606)	09/11/09
Referred to Senate Rules and Executive Nominations Committee	09/14/09
Senate concurred in House amendments to Senate amendments (32-17)	09/17/09
Signed by the Governor (Act 44 of 2009)	09/18/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	city is determined to be Level III distress on January 1, 2011; 16) Provide for the establishment of DROPs by the Pennsylvania Municipal Retirement System for its participating local governments; 17) Authorize a local government with a defined benefit pension plan to establish a DROP as part of the plan; 18) Prohibit future participation in DROPs by elected officials; and 19) Provide for the designation of an active member's spouse as beneficiary regardless of date of marriage.		
H. B. 1873 P. N. 2484 (Williams, J.)	SERS, defining "campus police officer" and providing age 50 superannuation retirement benefits to certain campus police officers.	Introduced and referred to House Finance Committee	07/20/09
H. B. 1874 P. N. 2522 (Caltagirone)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), this bill, together with its companion bill, House Bill Number 1884, Printer's Number 2523, would together implement a municipal pension plan funding relief and recovery program applicable to most of the Commonwealth's municipal pension systems. More specifically, the bill would: 1) create a new Act 205 recovery program with both voluntary and mandatory remedies applicable to most municipalities that operate pension plans; 2) mandate revised amortization schedules applicable to all future unfunded actuarial accrued liabilities incurred by municipal pension plans; 3) provide for optional, alternative, expanded asset smoothing methods for determination of the actuarial value of assets; 4) establish a new distress determination method using the pension plan ratio of assets to liabilities, based upon the most recent actuarial valuation report; 5) establish three new levels of distress (Level I - minimal, Level II - moderate and Level III - severe) with corresponding optional and mandatory remedies dependent upon the severity of distress; 6) mandate the transfer of severely distressed (Level III) municipal pension plans to Commonwealth management through the Pennsylvania Municipal Retirement System (PMRS); 7) mandate a uniform pension plan applicable to newly hired employees of Level III municipalities; 8) clarify the limitations on the uses of the special municipal taxing authority currently provided under the Act, and in the case of a municipality utilizing the pro-	Introduced and referred to House Appropriations Committee First Consideration Re-referred to House Rules Committee Re-referred to House Appropriations Committee **Actuarial Note (A. 03005)** Reported as amended **Commission Letter (P. N. 2522**) Second Consideration **Commission Letter (A. 03324)** **Commission Letter (A. 03321)** **Commission Letter (A. 03333)**	07/17/09 07/20/09 07/20/09 07/21/09 07/28/09 07/30/09 07/31/09 08/05/09 08/05/09 08/05/09 08/05/09

	ceeds from the special tax to fund other post-employment benefits (OPEBs), require the inclusion of OPEB liabilities in the actuarial valuation report filed with the Commission and in the calculation of the municipality's Minimum Municipal Obligation (MMO); 9) exempt a city of the first class (Philadelphia) from all mandatory remedies imposed by the new Act 205 recovery program; 10) permit, but not require the city of Philadelphia to re-amortize all of the unfunded actuarial accrued liabilities in the city's pension plans over a 30-year period using level dollar amortization payments; 11) over a multi-year period, permit the city of Philadelphia to defer payment of a portion of the city's Minimum Municipal Obligation (MMO) and implement a mandatory repayment schedule; 12) permit the city to raise additional revenues for the purpose of funding its pension plans through the temporarily imposition of a local sales and use tax of 1%; and 13) make various other changes to the Act that are of a technical, administrative or editorial nature.		
H. B. 1884 P. N. 2523 (Harhai)	PMRS, the bill is a companion bill to House Bill Number 1874, Printer's Number 2522, would amend the Pennsylvania Municipal Retirement Law (Act 15 of 1974) to: 1) establish the Municipal Pension Recovery Program mandated by House Bill Number 1874, Printer's Number 2522, effectuating the transfer of municipal pension plans that are deemed to be "severely distressed" (Distress Level III) from local administration to PMRS administration; 2) establish the Cooperative Municipal Pension and Security Program mandated by House Bill Number 1874, Printer's Number 2522, implementing a uniform pension program applicable to all newly hired employees of municipalities with severely distressed pension plans; 3) exempt any city of the first class from participation in the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) recovery program mandated by House Bill Number 1874, Printer's Number 2522; 4) address significant federal tax qualification issues affecting the administration of PMRS; and 5) make various other changes to the Act that are of a technical, administrative or editorial nature.	Introduced and referred to House Appropriations Committee **Actuarial Note (P. N. 2499)** Reported as amended First Consideration Re-referred to House Rules Committee **Commission Letter (P. N. 2523)** Re-referred to House Appropriations Committee Second Consideration **Commission Letter (A. 03322)** **Commission Letter (A. 03332)**	07/22/09 07/28/09 07/30/09 07/30/09 07/30/09 07/31/09 08/04/09 08/05/09 08/05/09 08/05/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
H. B. 1902 P. N. 2537 (Caltagirone)	Act 293 of 1972, amending the act to permit the actuarial studies of county pension plans subject to the Act to use any reasonable actuarial assumptions or methodologies, including, but not limited to, those provided in the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984).	Introduced and referred to House Appropriations Committee First Consideration **Commission Letter (P. N. 2537)** Re-referred to House Rules Committee Re-referred to House Appropriations Committee	08/03/09 08/04/09 08/04/09 08/04/09 08/06/09
H. B. 1931 P. N. 2578 (Boyle)	Emergency and Law Enforcement Personnel Death Benefits Act, amends the act to: 1) mandate payment of a killed-in-service death benefit to the surviving spouse or, if there is no surviving spouse, the minor child of a paid firefighter, ambulance service or rescue squad member, or law enforcement officer in an amount equal to the decedent's monthly salary at the time of death (adjusted annually by an amount equal to the increase in the Consumer Price Index), less the amount of any workers' compensation or pension benefit payable to an eligible beneficiary; 2) repeal Section 5(e)(2) of the Municipal Police Pension Law (Act 600 of 1955) which currently provides the killed-in-service death benefit applicable only to members of Act 600 pension plans; and 3) repeal Sections 202(b)(3)(vi) and (4)(vi) of the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) which provides for a special extended amortization period applicable to the funding of liabilities resulting from the payment of the Act 600 killed-in-service benefit.	Introduced and referred to House Finance Committee	08/13/09
H. B. 1938 P. N. 2587 (Boyle)	Emergency and Law Enforcement Personnel Death Benefits Act, amends the act to: 1) mandate payment of a killed-in-service death benefit to the surviving spouse or, if there is no surviving spouse, the minor child of a paid firefighter, ambulance service or rescue squad member, or law enforcement officer in an amount equal to the decedent's monthly salary (adjusted annually by an amount equal to the increase in the Consumer Price Index), less the amount of any workers' compensation or pension benefit payable to an eligible beneficiary; 2) repeal Section 5(e)(2) of the Municipal Police Pension Law (Act 600 of 1955) which currently provides the killed-in-service death benefit applicable only to members of Act 600 pension plans; and 3) repeal Sections 202(b)(3)(vi) and (4)(vi) of the Municipal Pension Plan Funding	Introduced and referred to House Finance Committee First Consideration Re-referred to House Rules Committee Re-referred to House Appropriations Committee	08/17/09 08/19/09 08/19/09 09/11/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	Standard and Recovery Act (Act 205 of 1984) which provides for a special extended amortization period applicable to the funding of liabilities resulting from the payment of the Act 600 killed-in-service benefit.		
H. B. 1963 P. N. 2630 (Benninghoff)	An act, effective November 30, 2009, establishing a "unified contribution pension plan," which is a defined contribution retirement plan applicable to all public employees (hired on or after November 30, 2009) of all public employers within the Commonwealth, including state, school, municipal, county and all other employers of a governmental or quasi-governmental nature.	Introduced and referred to House Finance Committee	09/09/09
H. B. 1970 P. N. 2691 (Daley)	PSERS and SERS, providing for the payment of an additional monthly supplemental annuity to all eligible annuitants of both systems beginning with the first payment after January 1, 2010, with the annuity determined on the basis of the most recent effective date of retirement.	Introduced and referred to House Finance Committee	09/22/09
H. B. 2135 P. N. 3058 (Grell)	PSERS, amends the Code to establish a mandatory class of service for all new members of PSERS effective June 30, 2010. The bill would create a new reduced benefit membership class (Class T-E) in PSERS that would be comprised of a defined benefit plan with a 1% benefit accrual rate and a defined contribution component with an employer contribution rate of 2% of member's compensation and a mandatory 3% member contribution rate.	Introduced and referred to House Finance Committee	01/06/10
H. B. 2173 P. N. 3026 (Caltagirone)	Title 71 (State Government), providing superannuation retirement benefits to a magisterial district judge at age 55 upon accrual of 24 eligibility points or age 60 upon accrual of 35 eligibility points.	Introduced and referred to House Finance Committee	12/15/09
H. B. 2207 P. N. 3093 (Saylor)	PSERS, effective July 1, 2009, amending the Code to exclude the Pennsylvania School Boards Association (PSBA) and its employees as a governmental entity in PSERS, with PSBA employees who were members in PSERS before the effective date of the act receiving a lump sum payment of the present value of their benefits accrued.	Introduced and referred to House Finance Committee	01/19/10
H. B. 2283 P. N. 3263 (Evans, D.)	PSERS, making an appropriation from the Public School Employees' Retirement Fund in the amount of $43,528,000, to provide for expenses of the Public School	Introduced and referred to House Appropriations Committee First Consideration Second Consideration	03/05/10 03/08/10 03/10/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	Employees' Retirement Board for the fiscal year beginning July 1, 2010.	Third Consideration and Final Passage (174-15)	03/15/10
		Referred to Senate Appropriations Committee	03/17/10
		First Consideration	06/14/10
		Second Consideration	06/15/10
		Third Consideration and Final Passage (50-0)	06/30/10
		Signed by the Governor (Act 5A of 2010)	07/06/10
H. B. 2284 P. N. 3264 (Evans, D.)	SERS, making an appropriation from the State Employees' Retirement Fund in the amount of $28,075,000, to provide for expenses of the State Employees' Retirement Board for the fiscal year beginning July 1, 2010.	Introduced and referred to House Appropriations Committee	03/05/10
		First Consideration	03/08/10
		Second Consideration	03/10/10
		Third Consideration and Final Passage (174-15)	03/15/10
		Referred to Senate Appropriations Committee	03/17/10
		First Consideration	06/14/10
		Second Consideration	06/15/10
		Third Consideration and Final Passage (50-0)	06/30/10
		Signed by the Governor (Act 6A of 2010)	07/06/10
H. B. 2324 P. N. 3349 (Murphy)	City of Scranton, changing certain eligibility requirements for the purchase of nonintervening military service credit by members who are policemen or firemen by removing the requirement that the member must have become a city employee within three years of release of active duty and inserting language mandating that the city permit the purchase and crediting of certain military service.	Introduced and referred to House Finance Committee	03/12/10
		Actuarial Note (P. N. 3349)	05/27/10
		First Consideration	09/28/10
		Re-referred to House Appropriations Committee	09/28/10
H. B. 2325 P. N. 3350 (Murphy)	City of Scranton, amending the Second Class City A Employee Pension Law, removing the statutory three year limit within which a member must commence employment with the city following military service in order to be eligible to purchase service credit for nonintervening military service and mandating that the city permit eligible active members to purchase up to five years of nonintervening military service credit.	Introduced and referred to House Finance Committee	03/12/10
		Actuarial Note (P. N. 3350)	05/27/10
		First Consideration	09/28/10
		Re-referred to House Appropriations Committee	09/28/10
H. B. 2333 P. N. 3368 (Caltagirone)	Title 71 (State Government), providing superannuation retirement benefits to a magisterial district judge at age 55 upon accrual of 24 eligibility points.	Introduced and referred to House Judiciary Committee	03/16/10
H. B. 2482 P. N. 3684 (Grove)	PSERS, the bill would repeal Section 333(n) of the act of June 27, 2006 (1st Sp. Sess., P.L.1873, No.1), known as the Taxpayer Relief Act, and beginning with the 2010-2011 school year and each school year thereafter, the Common-	Introduced and referred to House Finance Committee	04/30/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	wealth shall pay each school entity for member contributions made to the Public School Employees' Retirement Fund a payment to be reduced by 4% of the total compensation for all active members.		
H. B. 2493 P. N. 4093 (Eachus)	PMRS, amends the Pennsylvania Municipal Retirement Law (Act 15 of 1974) to provide for the administration and regulation of deferred retirement option plans (DROPs) in the Pennsylvania Municipal Retirement System, and to create certain provisions to comply with state and Federal law to ensure PMRS maintains tax qualified status under the Internal Revenue Code.	Introduced and referred to House Appropriations Committee	05/05/10
		Commission Letter (P. N. 3722)	05/18/10
		Commission Letter (A. 06959)	05/19/10
		First Consideration	05/24/10
		Second Consideration	05/26/10
		Third Consideration and Final Passage (103-85)	06/07/10
		Referred to Senate Finance Committee	06/08/10
		Reported as amended	06/30/10
		First Consideration	06/30/10
		Second Consideration	07/01/10
		Re-referred to Senate Appropriations Committee	07/01/10
		Commission Letter (P. N. 4059)	07/02/10
		Reported as amended	07/03/10
		Third Consideration and Final Passage (50-0)	07/03/10
		Referred to House Rules Committee	07/03/10
		House concurred in Senate amendments (115-80)	07/03/10
		Signed by the Governor (Act 56 of 2010)	07/09/10
H. B. 2497 P. N. 4476 (Evans, D.)	PSERS and SERS, amending the Codes of both systems to: 1) Effective July 1, 2011, create two new classes of membership for school employees, known as "Class T-E," and "Class T-F." New members of PSERS would become members of Class T-E, unless they elect Class T-F membership within 45 days of becoming a member of the System. Class T-E members would be eligible for an annuity of 2% with a corresponding employee contribution requirement of 7.5% of pay. Class T-F members would be eligible for an annuity of 2.5% with a corresponding employee contribution requirement of 10.3% of pay; 2) Effective January 1, 2011, create two new classes of membership for State employees (including members of the General Assembly), known as "Class A-3," and "Class A-4." Most new members of SERS would become members of Class A-3, unless they elect Class A-4 membership within 45 days of becoming a member of the System. Class A-3 members would be eligible for an annuity of 2% with a corresponding employee contribution requirement of 6.25% of pay. Class A-4 mem-	Introduced and referred to House Appropriations Committee	05/11/10
		Actuarial Note (P. N. 3730)	05/27/10
		Commission Letter (A. 06939)	05/28/10
		Commission Letter (A. 07318)	06/07/10
		Reported as amended	06/07/10
		First Consideration	06/07/10
		Commission Letter (A. 07647)	06/15/10
		Actuarial Note (A. 07493)	06/15/10
		Reported as amended	06/15/10
		Second Consideration	06/15/10
		Commission Letter (A. 07693)	06/16/10
		Third Consideration and Final Passage (192-6)	06/16/10
		Referred to Senate Finance Committee	06/17/10
		First Consideration	09/28/10
		Re-referred to Senate Finance Committee	09/29/10
		Actuarial Note (A. 09615)	10/12/10
		Commission Letter (A. 09638)	10/12/10
		Commission Letter (A. 09639)	10/12/10
		Reported as amended	10/12/10
		Second Consideration	10/12/10
		Re-referred to Senate Appropriations Committee	10/12/10
		Reported as amended	10/13/10
		Commission Letter (P. N. 4476)	10/14/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	bers would be eligible for an annuity of 2.5% with a corresponding employee contribution requirement of 9.3% of pay; 3) Increase the superannuation requirements for all new members of PSERS and SERS to age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 and at least 35 years of credited service; 4) Establish a variable employee contribution rate, known as the "shared risk contribution rate," applicable to all new members of PSERS and SERS that is linked to the investment performance of the pension funds; 5) Require new members who purchase most types of nonschool or nonstate service credit (other than intervening military service) to contribute an amount equal to the full actuarial cost of the service purchase; 6) Beginning July 1, 2011, for PSERS and July 1, 2010, for SERS, re-amortize all of the unfunded actuarial accrued liabilities over a 24-year period using level-percentage of pay amortization payments for PSERS and over a 30-year period using level-dollar amortization payments for SERS, instead of level percentage of pay amortization; 7) Beginning July 1, 2011, for PSERS, extend from five years to ten years the asset smoothing period over which the fund's investment gains and losses are recognized; 8) Modify employer contribution requirements to PSERS and SERS by "collars" on the rate at which employer contributions may rise from year to year. For the fiscal years beginning July 1, 2011, July 1, 2012, and on or after July 1, 2013, establish a temporary collared contribution rate, that if the contribution rate is more than 3%, 3.5% and 4.5%, respectively, of total pay of all active members greater than the prior year's final contribution rate, then the collared contribution rate shall be applied and equal to 3%, 3.5% and 4.5%, respectively, of total pay for all active members; 9) For all other fiscal years in which the actuarially required contribution rate is less than the collared rate, establish the final contribution rate as the actuarially required contribution rate, provided that the final contribution rate is not less than the employer normal contribution rate; 10) Limit the maximum annual retirement benefit of all new members of PSERS and SERS to not more than 100% of fi-	Third Consideration and Final Passage (41-8)	10/14/10
		Commission Letter (A. 09751)	10/15/10
		Received as amended and referred to House Rules Committee	10/18/10
		Advisory Note (A. 09760)	11/15/10
		House concurred in Senate amendments (165-31)	11/15/10
		Signed by the Governor (Act 120 of 2010)	11/23/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	nal average salary; 11) Eliminate new members' eligibility to withdraw their accumulated deductions in a lump sum at retirement under retirement Option 4; 12) Prohibit new members of SERS from purchasing Non-Qualified Part-Time Service (NQPTS), but extend the NQPTS election window of 365 days to Class T-E and T-F members as well as Class T-C and T-D members; 13) Prohibit the use of pension obligation bonds for funding liabilities; and 14) Establish an independent fiscal office charged with providing independent revenue estimates and other functions.		
H. B. 2559 P. N. 3861 (Houghton)	An Act establishing the Public Employee Pension Commission, to study and make recommendations with respect to the PSERS and SERS pension systems, including both short-term, as well as long-term, solutions to fill funding gaps and guarantee fiscal solvency.	Introduced and referred to House Finance Committee	06/08/10
H. B. 2594 P. N. 3947 (Godshall)	SERS, amending the Code by adding a new retirement option, known as Option 5, which guarantees the member periodic COLAs in return for the member leaving all accumulated deductions (member contributions) plus interest with the Fund upon retirement.	Introduced and referred to House Finance Committee	06/22/10
H. B. 2666 P. N. 4152 (Krieger)	SERS, establishing a mandatory defined contribution retirement program for persons who become members of the General Assembly after December 1, 2010, or who are re-elected to serve as a member of the General Assembly beginning on or after December 1, 2010. Matching employer contributions shall not exceed 4% of the member's compensation, while members can contribute to the program to the extent permitted by law.	Introduced and referred to House Finance Committee	08/23/10
H. B. 2718 P. N. 4355 (Grove)	SERS, amending the Code to exclude optional membership in the system for the Lieutenant Governor, which shall take effect upon the ratification of the amendment to the Constitution of Pennsylvania that abolishes the office of Lieutenant Governor.	Introduced and referred to House State Government Committee	09/28/10
H. B. 2773 P. N. 4459 (Santarsiero)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending listed offenses to include offenses related to endangering the welfare of children and offenses related to the corruption of minors.	Introduced and referred to House Finance Committee	10/07/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
H. B. 2784 P. N. 4487 (Boyd)	PSERS and SERS, amending the Codes of both systems to mandate the establishment of reduced benefit tiers for most new members of PSERS and SERS. The basic contribution rate for new members of "Class T-E" for PSERS and "Class QC" for SERS will be equal to 6% of compensation, with a corresponding employer contribution rate of 6%. An annuity will be provided to members based upon the balance of the member's "savings account," which is to be credited with annual interest at the rate of 6%. Superannuation age will be 55, or any age with 35 years of credited service. Excess interest will be credited annually to members of Class T-E and QC on the basis that the System is fully funded.	Introduced and referred to House Finance Committee	10/18/10
H. R. 18 P. N. 16 (Markosek)	A House Resolution directing the Legislative Budget and Finance Committee to study the feasibility and cost-effectiveness of placing approximately 15,000 transit agency employees under the Commonwealth's jurisdiction for the purposes of providing health benefits through the Pennsylvania Employee Benefit Trust Fund and pension benefits through the State Employees' Retirement System, and to report its findings to the House of Representatives by December 31, 2009.	Introduced and referred to House Transportation Committee Reported as committed Re-referred to House Rules Committee	01/26/09 01/27/09 02/03/09
H. R. 31 P. N. 104 (Yudichak)	A House Resolution directing the Legislative Budget and Finance Committee to study SERS and PSERS and make recommendations directed at ensuring solvency of each pension system and at limiting excessive tax increases on State and local taxpayers	Introduced and referred to House Finance Committee	01/30/09
H. R. 209 P. N. 1959 (Solobay)	A House Resolution directing the Legislative Budget and Finance Committee to examine the equity of the current formula for funding volunteer firefighters' relief associations, and to report its findings to the House of Representatives along with any recommended changes to the distribution formula within six months of passage of the resolution.	Introduced and referred to House Veterans Affairs & Emergency Prepared Committee Reported as amended	03/27/09 06/01/09
H. R. 505 P. N. 2804 (Reichley)	A House Resolution petitioning the Governor to call a special session of the General Assembly relating to the resolution of the underfunding of public pension funds.	Introduced and referred to House Finance Committee	10/14/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
S. B. 52 P. N. 37 (Greenleaf)	PSERS and SERS, reopening the "30 and Out" early retirement incentive for active members of PSERS for the period from April 1, 2009, through June 30, 2009, and again from April 1, 2010, through June 30, 2010; and for active members of SERS, for the period from July 1, 2009, through June 30, 2010.	Introduced and referred to Senate Finance Committee	01/20/09
S. B. 129 P. N. 102 (Erickson)	Emergency and Law Enforcement Death Benefits Act (Act 101 of 1976), providing a death benefit for the spouse or beneficiary of an ambulance service or rescue squad member working for a hospital killed in the performance of duty.	Introduced and referred to Senate Labor and Industry Committee	01/30/09
S. B. 130 P. N. 455 (Mellow)	PSERS and SERS, implementing a permanent "30 and out" early retirement incentive applicable to all active members of both Systems.	Introduced and referred to Senate Finance Committee	03/02/09
S. B. 270 P. N. 274 (Costa)	Second Class City (Pittsburgh) Firemen Relief Law, amending the law by removing current language requiring the cessation of pension payments to surviving spouses upon remarriage.	Introduced and referred to Senate Finance Committee **Commission Letter (P. N. 274)**	02/19/09 03/26/09
S. B. 271 P. N. 275 (Costa)	Second Class City (Pittsburgh) Employee Pension Law, amending the law by removing current language requiring the cessation of pension payments to surviving spouses upon remarriage.	Introduced and referred to Senate Finance Committee **Actuarial Note (P. N. 275)**	02/19/09 04/24/09
S. B. 274 P. N. 278 (Costa)	Second Class County Code, amending the definition of "compensation" to exclude overtime pay from the calculation of a member's retirement benefit; further providing for membership of the Allegheny County Retirement Board; and further providing for the calculation of retirement allowances.	Introduced and referred to Senate Finance Committee **Actuarial Note (P. N. 278)**	02/19/09 04/24/09
S. B. 359 P. N. 358 (Greenleaf)	SERS, defining "active duty for training" and authorizing the purchase of nonstate service credit for certain types of reserve or national guard military service for training purposes.	Introduced and referred to Senate Finance Committee	02/20/09
S. B. 360 P. N. 359 (Greenleaf)	PSERS, defining "nonpublic school," and permitting the purchase of up to five years of nonpublic school service credit for previous service as a school employee, teacher or instructor in a nonpublic school.	Introduced and referred to Senate Finance Committee	02/20/09
S. B. 369 P. N. 1478 (Logan)	Emergency and Law Enforcement Personnel Death Benefits Act, amends the act to: 1) mandate payment of a killed-in-service death benefit to the surviving spouse or, if there is no surviving spouse, the minor child of a paid fire-	Introduced and referred to Senate Labor and Industry Committee **Actuarial Note (P. N. 368)** Reported as amended First Consideration	02/20/09 03/19/09 06/23/09 06/23/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	fighter, ambulance service or rescue squad member, or law enforcement officer in an amount equal to the decedent's monthly salary (adjusted annually by an amount equal to the increase in the Consumer Price Index), less the amount of any workers' compensation or pension benefit payable to an eligible beneficiary; 2) repeal Section 5(e)(2) of the Municipal Police Pension Law (Act 600 of 1955) which currently provides the killed-in-service death benefit applicable only to members of Act 600 pension plans; and 3) repeal Sections 202(b)(3)(vi) and (4)(vi) of the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) which provides for a special extended amortization period applicable to the funding of liabilities resulting from the payment of the Act 600 killed-in-service benefit.	Re-referred to Senate Appropriations Committee **Commission Letter (P. N. 1197)** Second Consideration Third Consideration and Final Passage (47-0) Referred to House Labor Relations Committee First Consideration Re-referred to House Appropriations Committee **Commission Letter (A. 03745**) Reported as amended **Commission Letter (P. N. 1450)** **Commission Letter (A. 04053)** Floor amendment adopted Second Consideration Third Consideration and Final Passage (196-0) Referred to Senate Rules and Executive Nominations Committee Senate concurred in House amendments (49-0) Signed by the Governor (Act 51 of 2009)	07/09/09 07/11/09 08/12/09 08/26/09 08/27/09 09/11/09 09/15/09 09/17/09 10/01/09 10/02/09 10/06/09 10/07/09 10/07/09 10/08/09 10/08/09 10/09/09 10/09/09
S. B. 466 P. N. 476 (Gordner)	SERS, permitting certain employees of the State System of Higher Education who are currently members of an independent retirement program to elect membership in SERS.	Introduced and referred to Senate Finance Committee **Actuarial Note (P. N. 476)**	03/02/09 06/18/09
S. B. 565 P. N. 576 (Browne)	An Act, to be known and cited as the Other Postemployment Benefit Trust Act, providing for the establishment of trusts for the funding of postemployment, nonpension benefits of governmental employees, and mandating funding standards.	Introduced and referred to Senate Finance Committee	03/04/09
S. B. 566 P. N. 577 (Browne)	An Act, would amend Title 71 (State Government) by adding a new part, Part 27, titled "Unified Contribution Pension Plan." Chapter 71 of Part 27 would establish a new mandatory retirement system applicable to school and state employees hired after July 1, 2011. The new retirement system established by the bill as amended, known as the Public Employees' Retirement System (PERS), would be a defined contribution (DC) pension plan.	Introduced and referred to Senate Finance Committee **Actuarial Note (A. 08034)**	03/04/09 09/09/10
S. B. 633 P. N. 688 (Kasunic)	PSERS and SERS, mandating the payment of annual CPI-based COLAs to eligible annuitants of both Systems beginning July 1, 2009.	Introduced and referred to Senate Finance Committee	03/19/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
S. B. 634 P. N. 689 (Kasunic)	PSERS and SERS, amending the Codes of both systems to, beginning July 1, 2009, provide for mandatory, permanent, bi-annual cost-of-living adjustments equal to the change in CPI and payable to all annuitants of both systems.	Introduced and referred to Senate Finance Committee	03/19/09
S. B. 636 P. N. 691 (Kasunic)	An Act establishing the Annual Municipal Employee Postretirement Adjustment Act, mandating the payment of annual cost-of-living adjustments to all retired municipal employees of any borough, city, incorporated town or township by municipal retirement systems in amounts equal to the change in the CPI up to a maximum of 5% annually; mandating actuarial funding and reporting pursuant to Act 205; establishing a separate postretirement adjustment ledger account; providing for funding of the postretirement adjustments by deducting the required sums from funds available for General Municipal Pension System State Aid; and making repeals.	Introduced and referred to Senate Finance Committee	03/19/09
S. B. 661 P. N. 725 (Logan)	Second Class County Code, extending public safety employee pension benefit coverage to county detectives.	Introduced and referred to Senate Finance Committee	03/20/09
S. B. 762 P. N. 858 (Musto)	An Act, establishing the Public School Employees' Benefit Board, mandating a school employee benefits study, providing for a statewide health benefits program for public school employees, for retirement health savings plans, and establishing the Public School Employees' Benefit Trust Fund.	Introduced and referred to Senate Banking and Insurance Committee	04/03/09
S. B. 870 P. N. 1044 (Boscola)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending listed offenses to include offenses committed by a school administrator or teacher on school property.	Introduced and referred to Senate Finance Committee	05/27/09
S. B. 874 P. N. 1047 (Baker)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding that forfeited benefits shall be calculated from the date of initial arraignment.	Introduced and referred to Senate Finance Committee	05/27/09
S. B. 918 P. N. 2205 (Eichelberger)	Title 53, Municipalities Generally, consolidating and amending the Third Class County Assessment Board Law, the Fourth to Eighth Class and Selective County Assessment Law and provisions of the County Code relating to auxiliary board of assessment appeals and assessment of signs and sign structures; and making related repeals. Section 2 of	Introduced and referred to Senate Finance Committee First Consideration Floor amendment adopted Second Consideration **Commission Letter (A. 07087)** Floor Amendment Adopted Third Consideration and Final Passage (47-0)	06/05/09 07/15/09 05/04/10 05/04/10 05/25/10 05/25/10 05/26/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	the bill would add Chapter 91 (Municipal Pensions), Subchapter B (Cities of the Second Class) to require that notwithstanding the provisions of section 902(a)(2) of Act 205, any proceeds generated in connection with the lease or sale of the City of Pittsburgh's Parking Authority garages be deposited into: 1) the City's municipal pension system fund; or 2) a fund established within PMRS, in the event the City's pension fund is transferred to PMRS management under section 902(c) of Act 205. The bill would also require that if the administration of the City's pension fund is to be transferred to PMRS, that transfer will be accomplished by October 30, 2011.	Referred to House Local Government Committee	05/27/10
		Reported as amended	06/15/10
		First Consideration	06/15/10
		Re-referred to House Appropriations Committee	06/16/10
		Second Consideration	06/28/10
		Reported as amended	09/21/10
		Third Consideration and Final Passage (128-62)	09/27/10
		Referred to Senate Rules and Executive Nominations Committee	09/28/10
		Senate concurred in House amendments (49-0)	10/14/10
		Signed by the Governor (Act 93 of 2010)	10/27/10
S. B. 928 P. N. 1923 (Stack)	An Act, creating the Protecting Pennsylvania's Investments Act, requiring divestment of investment holdings in certain entities with business ties to the nations of Iran and Sudan and mandating the reimbursement of the affected public funds for investment losses incurred as a result of compliance with the bill's divestiture provisions by the Commonwealth from the General Fund.	Introduced and referred to Senate Finance Committee	07/17/09
		Commission Letter (P. N. 1329)	04/26/10
		Reported as amended	05/03/10
		First Consideration	05/03/10
		Second Consideration	05/04/10
		Re-referred to Senate Appropriations Committee	05/04/10
		Third Consideration and Final Passage (42-7)	05/05/10
		Referred to House State Government Committee	05/06/10
		First Consideration	05/25/10
		Re-referred to House Appropriations Committee	05/26/10
		Commission Letter (P. N. 1923)	06/09/10
		Second Consideration	06/21/10
		Third Consideration and Final Passage (200-0)	06/22/10
		Signed by the Governor (Act 44 of 2010)	07/02/10
S. B. 1000 P. N. 1257 (Logan)	Second Class County Code, reducing the age and service requirements for normal retirement benefit eligibility applicable to forensic investigators.	Introduced and referred to Senate Finance Committee	07/06/09
S. B. 1005 P. N. 1262 (White, M.)	County Pension Law (Act 96 of 1971), empowering the board of a county pension plan subject to the Act to provide for the payment of certain health care costs incurred by retired employees, provided the funded ratio of the pension plan is at least 100% and that the fund is "actuarially sound" as certified by the consulting actuary.	Introduced and referred to Senate Finance Committee	07/06/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
S. B. 1014 P. N. 1284 (Stack)	PSERS and SERS, providing for the payment of annual, CPI-based supplemental annuities to all eligible annuitants of both systems beginning July 1, 2010, and annually, thereafter.	Introduced and referred to Senate Finance Committee	07/10/09
S. B. 1015 P. N. 1285 (Argall)	SERS, authorizing the purchase of non-state service credit for certain previous employment in the mining industry.	Introduced and referred to Senate Finance Committee	07/10/09
S. B. 1042 P. N. 2141 (Browne)	PSERS and SERS, amending the Fiscal Code (Act 176 of 1929), to provide budget implementation language for the 2010-2011 General Appropriations Act. The bill further establishes that the FY 2010-11 composite rate for employer funding of PSERS shall be 5.64% and the composite rate for employer funding of SERS shall be 1% greater than the composite rate of 4.00% that applied for FY 2009-10.	Introduced and referred to Senate Finance Committee	07/19/09
		First Consideration	07/20/09
		Second Consideration	07/27/09
		Re-referred to Senate Appropriations Committee	07/27/09
		Amended on Third Consideration	10/05/09
		Third Consideration and Final Passage (36-13)	10/06/09
		Referred to House Appropriations Committee	10/06/09
		First Consideration	06/29/10
		Second Consideration	06/30/10
		Reported as amended	07/02/10
		Third Consideration and Final Passage (109-86)	07/03/10
		Referred to Senate Rules and Executive Nominations Committee	07/03/10
		Senate concurred in House amendments (39-11)	07/03/10
		Signed by the Governor (Act 46 of 2010)	07/06/10
S. B. 1058 P. N. 1359 (Kitchen)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205), the bill would amend the act to implement a modification of the actuarial funding requirements applicable to the city of Philadelphia's municipal employee retirement systems by: 1) permitting, but not requiring the city of Philadelphia to re-amortize all of the unfunded actuarial accrued liabilities in the city's pension plans over a 30-year period using level-dollar amortization payments; 2) over a multi-year period, permitting the city to defer payment of a portion of the city's Minimum Municipal Obligation (MMO) and mandating a repayment schedule applicable to any amounts deferred; and 3) permitting the city of Philadelphia to temporarily impose a local sales and use tax of 1%, with any moneys received from the sales and use tax being used only to pay the city's MMO. The bill would also exempt the city of Philadelphia from all mandatory remedies imposed by the new Act 205 municipal pension recovery program mandated by	Introduced and referred to Senate Finance Committee	07/31/09

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
	House Bill Number 1874, Printer's Number 2522.		
S. B. 1146 P. N. 1523 (Orie)	SERS, establishing a mandatory defined contribution retirement program for persons who become members of the General Assembly after December 1, 2010, or who are re-elected to serve as a member of the General Assembly beginning on or after December 1, 2010. Matching employer contributions shall not exceed 4% of the member's compensation, while members can contribute to the program to the extent permitted by law.	Introduced and referred to Senate Finance Committee	11/25/09
S. B. 1185 P. N. 1672 (Yaw)	PSERS, amends the Code to establish a mandatory class of service for all new members of PSERS effective June 30, 2010. The bill would create a new reduced benefit membership class (Class T-E) in PSERS that would be comprised of a defined benefit plan with a 1% benefit accrual rate and a defined contribution component with an employer contribution rate of 2% of member's compensation and a mandatory 3% member contribution rate.	Introduced and referred to Senate Finance Committee **Actuarial Note (P. N. 1672)**	02/03/10 05/27/10
S. B. 1223 P. N. 1660 (Mellow)	City of Scranton, changing certain eligibility requirements for the purchase of nonintervening military service credit by members who are policemen or firemen by removing the requirement that the member must have become a city employee within three years of release of active duty and inserting language mandating that the city permit the purchase and crediting of certain military service.	Introduced and referred to Senate Finance Committee	02/01/10
S. B. 1224 P. N. 1661 (Mellow)	City of Scranton, amending the Second Class City A Employee Pension Law, removing the statutory three year limit within which a member must commence employment with the city following military service in order to be eligible to purchase service credit for nonintervening military service and mandating that the city permit eligible active members to purchase up to five years of nonintervening military service credit.	Introduced and referred to Senate Finance Committee	02/01/10
S. B. 1228 P. N. 1678 (Leach)	Public Employee Retirement Commission Act (Act 66 of 1981), amending Section 9, pertaining to the contents of report, to include analyses and projections of future contribution requirements, funding ratios and postretirement health care benefits for municipal retirement systems.	Introduced and referred to Senate Finance Committee	02/04/10

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS AND HISTORY	DATE
S. B. 1352 P. N. 1947 (Farnese)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), permitting an active member of a retirement system of a first class city (Philadelphia) to purchase up to 10 years of prior service with the military; or as an employee of the Federal Government, State or political subdivision within the Commonwealth or a public school within the Commonwealth. Credited service may only be purchased if the member is currently vested in a retirement system and only for service for which the member is not entitled to a vested pension from another employer.	Introduced and referred to Senate Finance Committee	05/04/10
S. B. 1356 P. N. 1968 (Pileggi)	PMRS, amends the Pennsylvania Municipal Retirement Law (Act 15 of 1974) to provide for the administration and regulation of deferred retirement option plans (DROPs) in the Pennsylvania Municipal Retirement System, and to create certain provisions to comply with state and Federal law to ensure PMRS maintains tax qualified status under the Internal Revenue Code.	Introduced and referred to Senate Finance Committee	05/05/10
S. B. 1472 P. N. 2183 (White, D.)	SERS, establishing a mandatory defined contribution retirement program for persons who become members of the General Assembly after December 1, 2010, or who are re-elected to serve as a member of the General Assembly beginning on or after December 1, 2010. Matching employer contributions shall not exceed 4% of the member's compensation, while members can contribute to the program to the extent permitted by law.	Introduced and referred to Senate Finance Committee	09/15/10

APPENDIX E

CONCISE INDEX TO ACTUARIAL NOTES