PUBLIC EMPLOYEE RETIREMENT COMMISSION

2013 ANNUAL REPORT

Commonwealth of Pennsylvania

2013

Annual Report

of the

Public Employee Retirement Commission

Public Employee Retirement Commission
Commonwealth of Pennsylvania
February 2014

PUBLIC EMPLOYEE RETIREMENT COMMISSION

Gubernatorial Appointees

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

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

Mr. John J. Egan, Jr.
President, J. Egan Consulting, LLC

Mr. John T. Durbin
President, Durbin Associates

Mr. Michael P. Gleason, CPCU
Pittsburgh Branch Manager
The Gleason Agency, Inc.
A division of Arthur J. Gallagher
Risk Management Services

Legislative Appointees

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

Senator Daylin B. Leach
District 17
Delaware and Montgomery Counties

Representative Mike Tobash
District 125
Berks and Schuylkill Counties

Representative R. Ted Harhai
District 58
Fayette and Westmoreland Counties

Executive Director:	James L. McAneny
Commission Office:	510 Finance Building P. O. Box 1429 Harrisburg, PA 17105-1429
Telephone:	(717) 783-6100
FAX:	(717) 787-9531
E-mail:	perc@pa.gov
Web Site:	www.perc.state.pa.us

COMMONWEALTH OF PENNSYLVANIA
PUBLIC EMPLOYEE RETIREMENT COMMISSION
HARRISBURG
17120

February 12, 2014

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 2013.

During 2013, the Commission authorized the attachment of eleven actuarial notes to bills and amendments and provided four advisory notes 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. This report also describes research conducted during 2013 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 thirty-first 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 2013.

Sincerely,

Anthony W. Salomone
Chairman

DEDICATION

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

A. CARVILLE FOSTER, JR.

Mr. Foster was appointed as a member of the Public Employee Retirement Commission on March 31, 1993, and served faithfully and conscientiously in the capacity of member, vice chairman, and chairman until the end of his appointment on June 26, 2013.

During Mr. Foster's long tenure, the Commission issued more than 400 actuarial notes on proposed public employee pension legislation and issued numerous policy development reports to the Governor and the General Assembly.

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

Introduction

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

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

Under the Municipal Pension Plan Funding Standard and Recovery Act, adopted in 1984, the Commission has two additional responsibilities. The first is to administer the actuarial valuation reporting program for municipal retirement systems, which entails monitoring and enforcing compliance with the statutorily mandated actuarial funding standard. The second is to certify annually municipal pension cost data used in allocating General Municipal Pension System State Aid, an amount that exceeded $246 million in 2013.

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-eighth report issued on a calendar year basis, and the third to be issued solely in electronic format.

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 2013.

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont'd)

Page

TABLE OF CONTENTS (Cont'd)

Page

DUTIES AND RESPONSIBILITIES

OF THE COMMISSION

PART I

PREPARATION OF ACTUARIAL NOTES AND ADVISORY NOTES

A. STATUTORY PROVISIONS.

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

Section 6. Powers and duties.

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

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

Section 7. Actuarial notes.

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

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

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

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

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

A. STATUTORY PROVISIONS. (Cont'd)

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

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

B. SUMMARY OF 2013 ACTIVITY.

During 2013, the Commission authorized the attachment of eleven actuarial notes to bills and amendments at the request of the General Assembly. In addition, the Commission's staff provided the General Assembly with four advisory notes.

C. SYNOPSES OF ADVISORY NOTES.

- House Bill Number 1350, Printer's Number 1760. At the request of Representative William F. Adolph, Jr., Majority Chairman, House Appropriations Committee, on May 31, 2013, the Commission staff provided an advisory note on House Bill Number 1350, Printer's Number 1760. House Bill Number 1350, Printer's Number 1760, would amend both the Public School Employees' Retirement Code and State Employees' Retirement Code to: 1) Modify the employer contribution limits to PSERS and SERS enacted under Act 120 of 2010; 2) establish a defined contribution retirement benefit plan for new members under new chapters of the PSERS and SERS Codes; 3) Modify benefits for active members of both Systems by creating new classes of membership for current school and State employees; 4) modify the manner of determining the net annuity to make the Option 4 lump-sum withdrawal upon retirement actuarially cost neutral to the Systems for all employee contributions made after the year 2015 ; 5) modify the calculation of "final average salary" from the average of the highest three years of service to the average of the highest five years; 6) Further limit pensionable compensation for members to not exceed 110% of the average of the four preceding years of pensionable compensation for final average salary calculation purposes; and 7) Cap the pensionable compensation for final average salary at the Social Security wage base.

C. SYNOPSES OF ADVISORY NOTES. (CONT'D)

- House Bill Number 1581, Printer's Number 2146. At the request of Representative Kate M. Harper, Majority Chairman, House Local Government Committee, on December 24, 2013, the Commission Staff provided an advisory note on House Bill Number 1581, Printer's Number 2146. House Bill Number 1581, Printer's Number 2146, would establish a statewide retirement benefit plan to be known and cited as the "Cash Balance Pension Plan Act." Beginning January 1, 2013, the Act would be applicable to all newly hired police officers of Boroughs, Towns, Townships or regional police departments employing three or more full-time police officers, and all newly hired full-time police officers and firefighters of any city, excluding the City of Philadelphia.

- House Bill Number 1651, Printer's Number 2282. At the request of Representative Kate M. Harper, Majority Chairman, House Local Government Committee, on November 7, 2013, the Commission Staff provided an advisory note on House Bill Number 1651, Printer's Number 2282. House Bill Number 1651, Printer's Number 2282, would amend the Pennsylvania Municipal Retirement Law (Act 15 of 1974) to establish the Statewide Municipal Police Officers Pension Plan ("Plan"). The Plan would require mandatory membership in the Pennsylvania Municipal Retirement System (PMRS) as an Article IV-A member for any municipal police officer hired on or after January 1, 2014, excluding police officers hired by a city of the first or second class. Employer contributions to the plan would be no less than 7.5% of salary, with a mandatory employee contribution of 7.5% of salary. An Article IV-A member would be eligible for an annual benefit accrual rate of 2.5%, not to exceed 65% of the member's final salary. Membership in the plan for municipal police officers hired on or before December 31, 2013, will be optional.

- House Bill Number 1752, Printer's Number 2467. At the request of Representative Kate M. Harper, Majority Chairman, House Local Government Committee, on December 24, 2013, the Commission Staff provided an advisory note on House Bill Number 1752, Printer's Number 2467. House Bill Number 1752, Printer's Number 2467, would amend the Municipal Police Pension Law (Act 600 of 1955) to permit current members of an Act 600 municipal police pension plan to purchase service credit for up to five years of previous part-time police service.

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 703, Printer's Number 708

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

Subject: Eligibility for Purchase of Nonintervening Military Service

SYNOPSIS

Senate Bill Number 703, Printer's Number 708, 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. Senate Bill Number 703, Printer's Number 708, is a companion bill to Senate Bill Number 704, Printer's Number 709, which would similarly amend the pension statute affecting nonuniformed employees.

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, 2011, there were 150 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, 2011, there were 137 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 Reemployment 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 16, 2013, the Commission voted to attach the actuarial note to the bill, recommending that the General Assembly and the Governor consider the policy issue identified the actuarial note transmittal.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

Senate Bill Number 703, Printer's Number 708, received final passage in the Senate on December 10, 2013, and was referred to the House Urban Affairs Committee.

To view this note in its entirety, click the following link: Senate Bill Number 703, Printer's Number 708

Bill ID: Senate Bill Number 704, Printer's Number 709

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

Subject: Eligibility for Purchase of Nonintervening Military Service

SYNOPSIS

Senate Bill Number 704, Printer's Number 709, 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. Senate Bill Number 704, Printer's Number 709, is a companion bill to Senate Bill Number 703, Printer's Number 708, 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, 2011, there were 169 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 Reemployment 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 16, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

Senate Bill Number 704, Printer's Number 709, received final passage in the Senate on December 10, 2013, and was referred to the House Urban Affairs Committee.

To view this note in its entirety, click the following link: Senate Bill Number 704, Printer's Number 709

Bill ID: Senate Bill Number 742, Printer's Number 772

System: All Municipal Pension Systems

Subject: Act 205 – Professional Services Contracts

SYNOPSIS

Senate Bill Number 742, Printer's Number 772, would amend the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984) by altering the definition of "professional services contract" to exclude municipal pension systems with fewer than 100 active members from being required to develop and implement bidding procedures for entering into professional services contracts for investment services, legal services, real estate services, and other consulting services with respect to the municipal pension system.

DISCUSSION

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

Under Act 205, the Commission has three responsibilities. The first is to administer the actuarial valuation reporting program for municipal retirement systems that entails monitoring and enforcing compliance with the legislatively mandated actuarial funding standard and the biennial publication of municipal pension plan data for over 3,200 systems. The second is to annually certify municipal pension cost data used in allocating General Municipal Pension System State Aid (over $232 million in 2012). The last is to administer the Financially Distressed Municipal Pension System Recovery Program established by the Act.

Act 44 of 2009 was signed into law September 18, 2009, making numerous and significant changes to Act 205. Act 44 made available a number of actuarial tools intended to provide short-term fiscal relief to local governments operating public pension plans. The Act also regulated the establishment and operation of Deferred Retirement Option Plans (DROPs), and added a section (section 7) that established certain conduct and disclosure standards for professional service contracts applicable to municipal pension systems.

Taken as a whole, the 3,228 local government pension plans now operating in the Commonwealth are the equivalent of a fairly large public employee retirement system, with a total active membership of approximately 74,000 and total assets of $13.5 billion. However, a review of the Commission's records reveals that the vast majority (3,066 or 98%) of these plans are small, having fewer than 100 active members, and with 68 percent (2,123 plans) having fewer than ten active members. The Commission's data has also consistently shown that the smaller the plan size, the greater the administrative costs of the plan. In 2011, the per-member administrative costs for plans with fewer than 10 active members averaged $1,567.84. For plans having from 11 to 100 active members, the per-member administrative cost averaged $1,063.78. Surveys of public employee pension plans frequently use a threshold of 100 active members to categorize pension plans as either small or large, and the Commission has traditionally employed the 100 member threshold in its reporting.

DISCUSSION (CONT'D)

Prior to the passage of Act 44, small local governments most often engaged local businesses to provide actuarial, financial and other professional services for their pension plans without employing a formal bidding process. With the passage of Act 44, Section 702-A now requires all municipal pension plans subject to Act 205, regardless of size, to engage in a formal bidding process when contracting for services. The procedures include advertising to potential service providers, creation of applications and disclosure forms to be used for purposes of submitting proposals, and the manner in which such submitted proposals will be reviewed in order to select the most qualified person to enter into a professional services contract with the municipal pension system. This process can be time-consuming and expensive and is particularly onerous for small municipal pension plans, which make up the vast majority of municipal plans in the Commonwealth. The bill would limit the applicability of the Section 702-A contracting requirements to larger municipal plans having an active membership of 100 or more. In this way, the bill would have the beneficial effect of freeing small municipal plans from a time-consuming, costly, and unfunded state mandate.

SUMMARY OF ACTUARY COST IMPACT

The Commission's consulting actuary has reviewed the bill and determined that enactment of the bill would result in a reduction in the administrative costs associated with selecting individuals to enter into professional service contracts for most municipal pension systems subject to the requirements of Act 205. Since the bill does not affect the benefits provided under municipal pension systems subject to Act 205, there would be no actuarial cost impact resulting from enactment of the bill.

POLICY CONSIDERATIONS

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

> <u>Reduction in Administrative Cost to Municipalities</u>. The bill would serve to ease administrative complexity and reduce administrative costs in the affected local governments, and would prove particularly beneficial in those communities already facing significant fiscal challenges.
>
> <u>Elimination of Unfunded State Mandate</u>. Section 702-A imposes an additional, state-mandated, administrative burden upon local governments, but provides no additional state funding to implement that mandate. The bill would serve to eliminate a costly and unfunded state mandate now imposed on many local governments.

COMMISSION RECOMMENDATION

On May 16, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

Senate Bill Number 742, Printer's Number 772, was introduced and referred to the Senate Finance Committee on March 26, 2013.

To view this note in its entirety, click the following link: Senate Bill Number 742, Printer's Number 772

Bill ID: Senate Bill Number 791, Printer's Number 812

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

Subject: New Benefit Tier

SYNOPSIS

Senate Bill Number 791, Printer's Number 812, would amend the act of July 28, 1953, P. L. 723, No. 230, known as the Second Class County Code (Code), by establishing a new mandatory benefit tier applicable to county employees hired on or after the effective date of the bill. The bill would also amend Section 1703 of the Code by altering the membership composition of the Allegheny County Retirement Board, and would make technical amendments to the plan intended to ensure that the Allegheny County Employees' Retirement System is maintained as tax qualified under the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 401 (c)).

More specifically, the bill would amend the Code to make the following benefit modifications for employees hired on or after the effective date of the bill:

1) For nonuniformed employees, increase the length of service required to receive normal retirement benefits from 20 years to 25 years, while retaining age 60 normal retirement age;

2) For public safety employees, increase the length of service required to receive normal retirement benefits from 20 years to 25 years, while retaining age 50 normal retirement age for police officers and firefighters, and age 55 normal retirement age for the county sheriff, deputy sheriffs, prison guards and probation officers;

3) Increase the length of service required for vesting from 8 years to 10 years for all classes of employees;

4) For retirement benefit purposes, extend the period over which the final average salary is calculated from the highest 24 months of the last four years of employment to the highest 48 months of the last eight years of employment, or the last four years of employment if compensated on a bi-weekly basis;

5) Increase the length of service required to receive service increment benefits from 20 years to 25 years;

6) Increase the length of service required to be eligible for early retirement from eight years to ten years;

7) Increase the length of service required to be eligible for survivor benefits from eight years to ten years;

8) Increase the length of service required to be eligible for survivor benefits under disability retirement from 20 years to 25 years; and

9) Amend Section 1701 by altering the definition of "compensation" to exclude overtime compensation in excess of 10% of pay from the retirement benefit calculation.

Article 17 of the Second Class County Code (Code) provides the pension plan for employees of Allegheny County. The Allegheny County Retirement System (System) is a governmental, defined benefit pension plan. Membership in the System is mandatory for county employees. As of January 1, 2012, there were 7,408 active members of the System with an annual payroll of approximately $329 million. Under the Code, the normal retirement benefit is equivalent to 50 percent of the member's final average salary. The final average salary is calculated as the monthly average of the highest 24 months of compensation earned during the last 48 months of service prior to retirement.

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

Under the actuarial cost method used by the System, the System's consulting actuary employs a variety of demographic and economic assumptions that are used to determine the funding requirements of the retirement plan. Among these are assumptions for salary and salary growth applicable to the various groups of county employees. If actual plan experience differs significantly from the actuarial assumptions, for example, if the compensation used to calculate members' benefits is significantly greater than what the actuary assumed it would be, then the retirement system will suffer an actuarial loss. The bill would amend the definition of compensation applicable to all county employees hired on or after the effective date of the bill, to preclude overtime in excess of 10% of base pay from the calculation of a member's retirement benefit.

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

Only newly hired employees of Allegheny County would be subject to the benefit modifications mandated by the bill. All current employees of the county who are members of the System will continue to have the current final average salary calculation applied to the retirement benefit formula. If enacted, the bill's elimination of overtime compensation in excess of 10% of pay from the retirement benefit formula combined with the implementation of a less generous final average salary calculation would have the effect of functioning as a reduced benefit tier applicable to all new employees of the county.

Special retirement benefit coverage is provided to the various types of public safety employees who are employed by Allegheny County. The special coverage provided to the county sheriff, deputy sheriffs, prison guards and probation officers employed by the county is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 55 and has accumulated at least 20 years of service. The special coverage provided to firefighters and police officers is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 50 and has at least 20 years of service. The regular coverage provided to all other employees of the county is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 60 and has at least 20 years of service. The bill would amend the requirements to receive normal retirement benefits by increasing the length of service required to receive normal retirement benefits from 20 years to 25 years of service, while retaining age 50 normal retirement age for police officers and firefighters, age 55 normal retirement age for the county sheriff, deputy sheriffs, prison guards and probation officers, and age 60 normal retirement age for all other employees.

Certain early retirement benefit options are also available to employees of Allegheny County. Under early retirement "Option I" (section 1710(h)(1)), any county employee who has completed at least eight, but less than 20, years of service may retire voluntarily and receive a deferred benefit commencing at age 60. Alternatively, under "Option II" (section 1710(h)(2)), an employee who has accumulated at least eight, but less than 20, years of service and is at least age 55, but less than age 60, may elect to receive an early retirement benefit that is actuarially reduced by one-half of one percent for each month the employee is under age 60.

The bill would establish two additional early retirement options, "Option I-A" and "Option II-A," applicable only to county employees hired on or after the effective date of the bill. Under early retirement Option I-A (section 1710(h)(1.1)), any county employee who has completed at least ten, but less than 25, years of service may retire voluntarily and receive a deferred benefit commencing at age 60. Alternatively, under Option II-A (section 1710(h)(2.1)), an employee who has accumulated at least ten, but less than 25, years of service and is at least age 55, but less than 60, may elect to receive an early retirement benefit that is actuarially reduced by one-half of one percent for each month the employee is under age 60.

In addition to the normal retirement benefit provided by the System, any county employee who retires with more than 20 years of service is eligible to receive a service increment of two percent per year (computed upon the annual retirement allowance to which the employee is entitled) for each completed year of service beyond 20 years. No service increment is paid for more than 20 years of "excess" service. Under the bill, any county employee hired on or after the effective date of the bill who retires with more than 25 years of service would be eligible to receive a service increment of two percent per year for each completed year of service beyond 25 years. The service increment benefit would continue to be limited to no more than 20 years of "excess" service.

Currently, a county employee may elect to provide survivor benefits for a spouse. Survivor benefits may be provided to the surviving spouse of a deceased employee upon the condition that the employee had attained age 50 and completed at least eight, but less than 19, years of service in order for a surviving spouse to be eligible for a reduced retirement option benefit at the time the deceased spouse would have reach aged 55. For employees who complete 20 or more years of service and die before reaching age 50, the surviving spouse is eligible to immediately receive a reduced retirement option. For county employees hired on or after the effective date of the bill, survivor benefits may be provided to the surviving spouse of a deceased employee upon the condition that the employee had attained age 50 and completed at least ten, but less than 24, years of service and died before reaching age 55. A reduced retirement option benefit would be provided to the surviving spouse at the time the deceased spouse would have reached age 55. For an employee who completed 25 or more years of service and died before reaching age 50, the surviving spouse would be eligible to immediately receive a reduced retirement option.

Currently, a county employee retiring under disability retirement can qualify for survivor benefits if the employee has reached age 55 and completed 20 or more years of service. The employee would be eligible for the same benefits as if retiring under normal retirement. A county employee retiring under disability with at least twelve, but less than 20, years of service is eligible upon reaching age 55 for survivor benefits. The surviving spouse receives a maximum amount of $75 per month upon the deceased spouse's death. Under the bill, any county employee hired on or after the effective date of the bill and retiring under disability retirement would qualify for survivor benefits if the employee has reached age 55 and completed 25 or more years of service. The employee would be eligible for the same benefits as if retiring under normal retirement. Any county employee retiring under disability retirement with at least twelve, but less than 25, years of service would be eligible upon reaching age 55 for survivor benefits. The surviving spouse would receive a maximum amount of $75 per month upon the deceased spouse's death.

Comparison of Benefits for Current Employees and Future Employees After the Effective Date of the Bill

	Current Employees	Future Employees
Eligibility Requirements for Normal Retirement	**Non-Uniformed:** Age 60 and 20 years of service **Police & Firefighters:** Age 50 and 20 years of service **Sheriffs, Deputies, Prison Guards & Probation Officers:** Age 55 and 20 years of service	**Non-Uniformed:** Age 60 and 25 years of service **Police & Firefighters:** Age 50 and 25 years of service **Sheriffs, Deputies, Prison Guards & Probation Officers:** Age 55 and 25 years of service
Benefit Accrual Per Year of Service	1/20th of normal retirement benefit	1/25th of normal retirement benefit
Service Increment Benefit	2.0% of annual retirement allowance for years of service between 20 and 40 years	2.0% of annual retirement allowance for years of service between 25 and 45 years
Vesting	100% after 8 years of service	100% after 10 years of service
Early Retirement	After 8 years but less than 20 years of service	After 10 years but less than 25 years of service
Compensation	Include overtime pay	Excludes overtime pay in excess of 10% of base pay
Average Monthly Compensation for Benefit Purpose	Highest 24 months of the last 4 years of employment or 2 years of employment on a bi-weekly pay basis	Highest 48 months of the last 8 years of employment or 4 years of employment on a bi-weekly pay basis

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill, the demographic data provided by the Allegheny County Employees' Retirement System, and the calculations performed by the System's consulting actuary with respect to the impact of including overtime up to 10% of base pay for purposes of computing retirement benefits. Because the benefit modifications mandated by the bill would apply only to employees hired on or after the effective date of the bill, the Commission's consulting actuary determined there would be no change to the System's current actuarial accrued liability. However, future normal cost will gradually decline as new employees subject to the reduced benefit provisions of the bill are hired and current employees gradually leave service. The following table shows the estimated decrease in future annual normal cost in time increments of 5, 10, 15 and 20 years after the effective date of the bill.

Estimated Decrease in Future Annual Normal Cost
After the Effective of the Bill

Years After Effective Date of Senate Bill No. 791	Decrease in Normal Cost	Decrease in Normal Cost as Percentage of Estimated Active Payroll
5	$ 2,067,000	0.54%
10	$ 4,993,000	1.13%
15	$ 8,841,000	1.72%
20	$14,036,000	2.36%

Under current law, a typical county employee retiring at age 60 with 20 years of service would receive a monthly retirement benefit of $1,844. Under the bill, a typical future county employee working the same number of years and retiring at the same age would receive a monthly retirement benefit of $1,425. This would amount to a benefit reduction of 22.7% for future employees. However, if a future county employee was to work five years longer, for a total of 25 years of service and retire at age 60, the monthly retirement benefit would improve to $1,781 (compared to $2,028 for a current county employee), a benefit reduction of 12.2% compared to a current county employee.

POLICY CONSIDERATIONS

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

> <u>Reduction in Normal Cost</u>. The bill would amend the definition of compensation applicable to all county employees hired on or after the effective date of the bill, to preclude overtime in excess of 10% of pay in the calculation of a member's retirement benefit. The bill would also mandate a less generous final average salary calculation applicable to newly hired county employees. Although these changes would do nothing to reduce the liabilities attributable to the benefit accruals of current active members, together they would have the effect of reducing the normal cost associated with the retirement benefit accruals of future employees.
>
> <u>Reduced Benefit Tier</u>. If enacted, the bill's exclusion of overtime compensation in excess of 10% of pay from the retirement benefit formula combined with the implementation of a less generous final average salary calculation would have the effect of functioning as a reduced benefit tier applicable to new employees of the county.
>
> <u>Benefit Disparity</u>. By implementing a reduced benefit tier, the bill creates the potential for benefit inequities in the treatment of similarly situated public employees that may result in employee bargaining disputes and subsequent litigation over benefit disparities.
>
> <u>Retirement Board Composition</u>. The bill would amend Section 1703 of the Code to alter the composition of the Allegheny County Retirement Board by replacing certain elected officials with appointed county officials. The General Assembly must determine whether it is appropriate to replace the elected officials with appointed officials.

COMMISSION RECOMMENDATION

On September 18, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

Senate Bill Number 791, Printer's Number 812, was introduced and referred to the Senate Finance Committee on April 1, 2013.

To view this note in its entirety, click the following link: Senate Bill Number 791, Printer's Number 812

Bill ID: Senate Bill Number 797, Printer's Number 817

System: Public School Employees' Retirement System

Subject: Compliance with HEART Act, USERRA and IRC §414(u)

SYNOPSIS

Senate Bill Number 797, Printer's Number 817, would amend Titles 51 (Military Affairs) and 24 (Public School Employees' Retirement Code) to bring the Public School Employees' Retirement System (PSERS) into compliance with the following Federal laws: 1) the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act"); 2) the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"); and 3) Internal Revenue Code Section 414(u) [IRC §414(u)]. Senate Bill Number 797, Printer's Number 817, is a companion bill to Senate Bill Number 798, Printer's Number 818, which would further bring PSERS into compliance with Federal law by amending the act of March 10, 1949, (P. L. 30, No. 14), known as the Public School Code of 1949, to entitle members of the System who are granted leave for military service on or after July 1, 2013, to receive credit in PSERS and to purchase the service as "nonintervening" military service, as provided in the Retirement Code.

The key provisions of the bill that would bring the PSERS Code into compliance with the Federal statutes include:

1) Beginning on July 1, 2013, the PSERS Code and Pennsylvania Military Code rules for PSERS service credit for "intervening military service" and military leaves of absence would be replaced by the USERRA rules for military service leaves.

2) Under the HEART Act, PSERS members who die on military leave will be granted vesting credit for the period of military service prior to their death for the purpose of qualifying for benefits and applying early retirement reduction factors, even though no retirement contributions are made.

3) Under USERRA, PSERS members who return to school service but do not make the employee contributions to purchase credit for the USERRA covered military leave will still be granted vesting credit for the period of military service for the purpose of qualifying for benefits and applying early retirement reduction factors.

4) IRC §414(u) requires that PSERS members (and consequently employers) actually make the contributions for credit for USERRA-covered military leave within the shorter of three times the length of the leave or five years after returning to school service, unless the member dies or retires during that time. The longer payment periods and payment by actuarial debt currently allowed under the PSERS Code will no longer be available, except under very specific and limited conditions.

5) USERRA prohibits charging interest on member contributions paid for USERRA leave.

6) PSERS members on military leave will not be permitted to make contributions until after they return to school service. Currently under the Military Code, members must make contributions while on leave.

7) In general, employer payments to compensate school employees on military leave will not be included in retirement covered compensation and no employee or employer contributions will be collected. However, in some circumstances, particularly when employees are on school military leave under §4102 of the Military Code, the payments that they receive will be included in the calculation of Final Average Salary and for other benefit calculation purposes.

8) Military leave that does not qualify for PSERS credit under USERRA, but would otherwise be creditable in PSERS under current definitions of creditable military service, intervening military service and military service leave can be purchased as nonintervening military service credit.

DISCUSSION

The Retirement Code and System

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. As of June 30, 2012, there were approximately 773 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS.

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, 2012, there were 273,504 active members and 202,015 annuitant members of PSERS.

For most members of the System, 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. Within PSERS, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school employees.

Act 120 of 2010 implemented major pension reform that affected the System, including the establishment of new benefit tiers applicable to most new members. Effective July 1, 2011, new members of PSERS are required to become members of one of two membership classes, known as "Class T-E" and "Class T-F." Most new members of PSERS are required to become members of Class T-E beginning July 1, 2011. Class T-E members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution of 7.5% of compensation. As an alternative to Class T-E, an employee who becomes a member of PSERS on or after July 1, 2011, may elect Class T-F membership within 45 days of becoming a member of PSERS. A Class T-F member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 10.3% of compensation.

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. For most members of PSERS who first became members after the effective date of Act 120, the superannuation requirement is age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 with at least 35 years of credited service.

Service Credit Purchase

Active members of both PSERS and the State Employees' Retirement System (SERS) may purchase certain types of service credit for retirement purposes. The types of service that may be purchased include prior school and State service. Additionally, various types of nonschool and nonstate service may be purchased by members and credited to them for retirement purposes. Historically, service purchases of all types have been paid for, in part or in full, by active members through either payroll deductions or in lump-sum payments.

One of the most common service purchase authorizations provided by public employee retirement systems is for periods of military service which interrupt (intervening military service) or delay (nonintervening military service) 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.

PSERS credit for military leave service is governed by several bodies of law: 1) the Public School Employees' Retirement Code, Title 24 Pa. C. S. §8101 *et seq.* (Retirement Code); 2) the Pennsylvania Military and Veterans Code, Title 51, Pa. C. S. §§4102, 7301-7309 (Military Code); 3) the Public School Code, 24 P.S. §11-1178 (School Code); and 4) Federal law, primarily the HEART Act , USERRA and the IRC. These bodies of law have different and sometimes inconsistent terms, conditions, requirements and PSERS benefit consequences pertaining to PSERS credit for military leave service. Senate Bill Number 797, Printer's Number 817, brings PSERS into compliance with the HEART Act, USERRA and IRC by removing inconsistencies in the law through amendments to the Military Code and the Retirement Code. Likewise, Senate Bill Number 798, Printer's Number 818, the companion bill to Senate Bill Number 797, Printer's Number 817, brings PSERS into compliance through an amendment to the School Code.

Uniformed Services Employment and Reemployment Rights Act

In 1994, the United States Congress passed the Uniformed Services Employment and Reemployment Rights Act (USERRA), which replaced the former Veterans' Reemployment Rights Law (VRRL). All private and governmental employers must comply with USERRA, which provides special employment and benefit rights to individuals who leave employment to perform "qualified military service." Qualified military service is service in the "uniformed services" while on active or inactive duty, including training periods. Uniformed services include the Army, Navy, Air Force, Marines, Coast Guard, Reserves, Army and Air National Guard, the commissioned corps of the Public Health Service, and any other persons designated by the President.

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)).

The Heroes Earnings Assistance and Relief Tax Act

The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act") was signed into law by the President on June 17, 2008, to provide additional tax and pension benefits to individuals who are absent from work due to duty in the uniformed military service. While USERRA was enacted to protect the reemployment rights of those who leave employment to serve in the military, the HEART Act clarified and expanded USERRA to provide benefits and vesting protection for those who could not return to work because of death or disability while performing military service.

The HEART Act imposes several mandatory provisions on all private and governmental retirement plans, with private plans in general being required to amend their plans by the last day of the first plan year beginning on or after January 1, 2010. For governmental retirement plans, the plans must be amended to reflect the mandatory provisions of the HEART Act by the last day of the first plan year beginning on or after January 1, 2012. The following is a description of the mandatory provisions required to be adopted by governmental retirement plans to be in compliance with the HEART Act.

Qualified plans must treat members who die on or after January 1, 2007, while performing qualified military service as having died during covered employment for purposes of entitlement to certain additional benefits under the plan. These additional benefits include accelerated vesting, ancillary life insurance benefits, and other benefits that are contingent upon the participant's termination of employment due to death. The HEART Act does not require plans to pay any benefit that a member who dies or becomes disabled would have accrued during the period of military service — though plans may do so voluntarily.

Some employers make differential wage payments to their employees who are called to active duty in the uniformed services. "Differential wage payments" (or "differential pay") are typically the difference between the individual's normal pay from the employer and his military pay. Employers are not required to make these wage payments, but for those that do, the HEART Act changed their tax treatment. Under the HEART Act, differential wage payments made after December 31, 2008, are considered W-2 wages. As a result, individuals receiving such payments are considered to be active employees of the employer.

Upon the death of a member while performing qualified military service, surviving beneficiaries receive payment under the Servicemembers' Group Life Insurance (SGLI) program. The HEART Act provides for the rollover of a military death gratuity or SGLI payment into an individual retirement account (IRA), Roth IRA or an education savings account with no annual limit on the contribution.

Internal Revenue Code Section 414(u)

Section 414(u) of the Internal Revenue Code [IRC §414(u)] provides rules regarding the interaction of USERRA with the rules governing tax-qualified retirement plans. Section 414(u)(8) provides, in part, that an employer maintaining a plan is treated as meeting the requirements of USERRA only if: 1) an employee re-employed under USERRA is treated as not having incurred a break in service because of the period of military service; 2) the employee's military service is treated as service with the employer for vesting and benefit accrual purposes; 3) the employee is permitted to make additional elective deferrals and employee contributions in an amount not exceeding the maximum amount the employee would have been permitted or required to contribute during the period of military service if the employee actually had been employed by the employer during that period; and 4) the employee is entitled to any accrued benefits that are contingent on employee contributions or elective deferrals to the extent the employee pays the contributions or elective deferrals to the plan.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill and the actuarial cost estimate provided to the Commission by the consulting actuary for PSERS. Despite the many changes required to bring PSERS into compliance with the HEART Act, USERRA and IRC §414(u), the Commission's consulting actuary does not expect these changes to materially impact the future funding requirements of PSERS.

There is no additional cost to the System associated with a member's purchase of benefit accrual service since the full cost is paid for by the member and the employer. There may be future additional costs associated with granting eligibility service while on USERRA leave. However, the System does not currently make any assumptions with respect to members returning from military leave or dying while on military leave.

POLICY CONSIDERATIONS

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

> Substantial Compliance with Federal Law. The bill attempts to bring the PSERS Code and Military Code into conformance with Federal Law by making amendments that are consistent with the mandatory provisions of the HEART Act, USERRA and IRC §414(u).
>
> Tax Qualification. The bill should be reviewed by qualified legal counsel specializing in tax-qualification issues to ensure IRC compliance.

COMMISSION RECOMMENDATION

On May 16, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

A later version of Senate Bill Number 797 was signed into law by the Governor on July 1, 2013.

To view this note in its entirety, click the following link: Senate Bill Number 797, Printer's Number 817

Bill ID: Senate Bill Number 798, Printer's Number 818

System: Public School Employees' Retirement System

Subject: Purchase of military service

SYNOPSIS

Senate Bill Number 798, Printer's Number 818, would amend the act of March 10, 1949, (P. L. 30, No. 14), known as the Public School Code of 1949, to entitle members of the Public School Employees' Retirement System (PSERS) who are granted leave for military service on or after July 1, 2013, to receive credit in PSERS and to purchase the service as "nonintervening" military service, as provided in Title 24. Senate Bill Number 798, Printer's Number 818, is a companion bill to Senate Bill Number 797, Printer's Number 817, which would amend Titles 51 (Military Affairs) and 24 (Public School Employees' Retirement Code) to bring PSERS into compliance with the following Federal laws: 1) the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act"); 2) the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"); and 3) Internal Revenue Code Section 414(u) [IRC §414(u)].

DISCUSSION

The Retirement Code and System

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. As of June 30, 2012, there were approximately 773 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS.

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, 2012, there were 273,504 active members and 202,015 annuitant members of PSERS.

For most members of the System, 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. Within PSERS, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school employees.

Act 120 of 2010 implemented major pension reform that affected the System, including the establishment of new benefit tiers applicable to most new members. Effective July 1, 2011, new members of PSERS are required to become members of one of two membership classes, known as "Class T-E" and "Class T-F." Most new members of PSERS are required to become members of Class T-E beginning July 1, 2011. Class T-E members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution of 7.5% of compensation. As an alternative to Class T-E, an employee who becomes a member of PSERS on or after July 1, 2011, may elect Class T-F membership within 45 days of becoming a member of PSERS. A Class T-F member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 10.3% of compensation.

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. For most members of PSERS who first became members after the effective date of Act 120, the superannuation requirement is age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 with at least 35 years of credited service.

Service Credit Purchase

Active members of both PSERS and the State Employees' Retirement System (SERS) may purchase certain types of service credit for retirement purposes. The types of service that may be purchased include prior school and State service. Additionally, various types of nonschool and nonstate service may be purchased by members and credited to them for retirement purposes. Historically, service purchases of all types have been paid for, in part or in full, by active members through either payroll deductions or in lump-sum payments.

One of the most common service purchase authorizations provided by public employee retirement systems is for periods of military service which interrupt (intervening military service) or delay (nonintervening military service) 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.

PSERS credit for military leave service is governed by several bodies of law: 1) the Public School Employees' Retirement Code, Title 24 Pa. C. S. §8101 *et seq.* (Retirement Code); 2) the Pennsylvania Military and Veterans Code, Title 51, Pa. C. S. §§4102, 7301-7309 (Military Code); 3) the Public School Code, 24 P. S. §11-1178 (School Code); and 4) Federal law, primarily the HEART Act , USERRA and the IRC. These bodies of law have different and sometimes inconsistent terms, conditions, requirements and PSERS benefit consequences pertaining to PSERS credit for military leave service. Senate Bill Number 797, Printer's Number 817, the companion bill to Senate Bill Number 798, Printer's Number 818, brings PSERS into compliance with the HEART Act, USERRA and IRC by removing inconsistencies in the law through amendments to the Military Code and the Retirement Code. Likewise, Senate Bill Number 798, Printer's Number 818, brings PSERS into compliance through an amendment to the School Code.

One of the amendments to the Retirement Code in Senate Bill Number 797, Printer's Number 817, would be a change in the crediting of military service leave. Under the bill, military leave that does not qualify for PSERS credit under USERRA, but would otherwise be creditable in PSERS under current definitions of creditable military service, intervening military service and military service leave can be purchased as "nonintervening" military service credit. Senate Bill Number 798, Printer's Number 818, reflects this proposed change in military service credit by also amending the related section of the School Code. Section 1178 of the School Code would be amended to permit members of the System to receive credit in PSERS for military leave taken on or after July 1, 2013, and to purchase the service as nonintervening military service, as provided in the amendments to Section 8302 of Title 24 (through Senate Bill Number 797, Printer's Number 817).

Uniformed Services Employment and Reemployment Rights Act

In 1994, the United States Congress passed the Uniformed Services Employment and Reemployment Rights Act (USERRA), which replaced the former Veterans' Reemployment Rights Law (VRRL). All private and governmental employers must comply with USERRA, which provides special employment and benefit rights to individuals who leave employment to perform "qualified military service." Qualified military service is service in the "uniformed services" while on active or inactive duty, including training periods. Uniformed services include the Army, Navy, Air Force, Marines, Coast Guard, Reserves, Army and Air National Guard, the commissioned corps of the Public Health Service, and any other persons designated by the President.

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)).

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill and the actuarial cost estimate provided to the Commission by the consulting actuary for PSERS. Despite the many changes required to bring PSERS into compliance with the HEART Act, USERRA and IRC §414(u), the Commission's consulting actuary does not expect these changes to materially impact the future funding requirements of PSERS. The amendatory language in the bill is administrative in scope and presents no additional cost to PSERS.

POLICY CONSIDERATIONS

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

> Substantial Compliance with Federal Law. The bill attempts to bring the School Code into conformance with Federal Law by making amendments that are consistent with the mandatory provisions of USERRA.

COMMISSION RECOMMENDATION

On May 16, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

Senate Bill Number 798, Printer's Number 818, was signed into law by the Governor on July 1, 2013.

To view this note in its entirety, click the following link: [Senate Bill Number 798, Printer's Number 818]

Bill ID: Senate Bill Number 922, Printer's Number 1252, as amended by Amendment Number 02498

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

Subject: Defined Contribution Retirement Plans

SYNOPSIS

Senate Bill Number 922, Printer's Number 1252, would amend the Public School Employees' Retirement Code of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement Code of the State Employees' Retirement System (SERS) to:

1) Effective July 1, 2015, establish a defined contribution retirement benefit plan under a new chapter of the PSERS Code, Chapter 84, called the School Employees' Defined Contribution (DC) Plan. All new school employees or employees returning after a break in service would become participants in the new plan. Membership in the PSERS' defined benefit retirement plan would be closed to all new or returning employees. School employees participating in the DC plan would contribute 7.5% of compensation with an employer contribution of 4% of compensation. Current PSERS members may elect to participate in the DC plan prospectively;

2) Effective January 1, 2015, establish a defined contribution retirement benefit plan under a new chapter of the SERS Code, Chapter 54, called the State Employees' Defined Contribution (DC) Plan. Most new State employees or employees returning after a break in service will become participants in the new plan, other than Pennsylvania State Police Officers and correction officers. Membership in the SERS' defined benefit retirement plan would be closed to all new or returning employees, except for State Police Officers or correction officers. Most State employees participating in the DC plan would contribute 6.25% of compensation with an employer contribution of 4% of compensation. For hazardous duty employees (including Capitol Police and park rangers), the employer contribution rate would be 5.5% of compensation. Current SERS members may elect to participate in the DC plan prospectively; and

3) For SERS, require all members of the General Assembly, members of the Judiciary, the Governor, the Lieutenant Governor, the Attorney General, the Auditor General and the Treasurer, who are current active members of SERS and are re-elected or retained on or after January 1, 2015, to become mandatory participants in the State Employees' DC Plan.

Amendment Number 02498 would amend the bill to:

1) For PSERS, remove the language in the bill that would further limit the rate at which employer contributions may rise from year to year, thus restoring the employer contribution collars enacted under Act 120 of 2010.

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 the Public School Employees' Retirement System and the State Employees' Retirement System is to provide retirement allowances and other benefits, including disability and death benefits to public school and State employees. As of June 30, 2012, there were approximately 773 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS, and as of December 31, 2012, approximately 105 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, 2012, there were 273,504 active members and 202,015 annuitant members of PSERS, and as of December 31, 2012, there were 106,048 active members and 117,061 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 compensation to PSERS, while most members of SERS are Class AA members and contribute 6.25% of compensation to SERS. 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.

Act 120 of 2010 implemented major pension reforms, including the establishment of new benefit tiers applicable to most new members. Effective January 1, 2011, most new members (including members of the General Assembly), are required to become members of one of two membership classes, known as "Class A-3" and "Class A-4." Most new members of SERS, other than State Police officers or members employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, become members of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010). Class A-3 members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution requirement of 6.25% of compensation. As an alternative to Class A-3, an employee who becomes a member of SERS on or after January 1, 2011, may elect Class A-4 membership within 45 days of becoming a member of SERS. A Class A-4 member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 9.3% of compensation.

Effective July 1, 2011, new members of PSERS are required to become members of one of two membership classes, known as "Class T-E" and "Class T-F." Most new members of PSERS are required to become members of Class T-E beginning July 1, 2011. Class T-E members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution of 7.5% of compensation. As an alternative to Class T-E, an employee who becomes a member of PSERS on or after July 1, 2011, may elect Class T-F membership within 45 days of becoming a member of PSERS. A Class T-F member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 10.3% of compensation.

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 for most members 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. For most members of the Systems who first became members after the effective dates of Act 120, the superannuation requirement is age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 with at least 35 years of credited service, and age 55 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 plan proposed in the bill as amended for new or returning school and State employees, 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 entail 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 as employees approach retirement age.

Defined Contribution Plans for School and State Employees

The bill as amended would establish two new mandatory retirement plans applicable to all public employees hired by school or State employers within the Commonwealth after July 1, 2015, in the case of PSERS, and January 1, 2015, in the case of SERS. The new governmental retirement plans, known as the School Employees' Defined Contribution Plan and the State Employees' Defined Contribution Plan ("Plans"), would replace the defined benefit plans provided by PSERS and SERS with defined contribution retirement plans for new school and State employees or employees returning after a break in service on or after the year 2015. Membership in both PSERS and SERS would be closed to new entrants or returning employees effective July 1, 2015, for PSERS, and January 1, 2015, for SERS. The exception would be for Pennsylvania State Police Officers and correction officers. All prospective employees of these groups would continue to be eligible for membership in SERS after 2015. Current members of PSERS and SERS would retain membership in the Systems, with the exception of the certain elected officials, as detailed in the DC plans' major issues below.

A current member of PSERS or SERS may choose to become a "participant" in the new DC plans of the respective Systems, at which point they would cease accruing service credit in PSERS or SERS. Membership benefits already accumulated prior to election in the DC plan would be frozen in the Systems, but available to the employee upon retirement. Election to participate in the plan can be made at any time, and would be an irrevocable election. An employee who is both a member of the System and a participant in the plan would be known as a "combined service employee." After electing to participate in the Plan, the employee would be prohibited from purchasing any previous school or creditable nonschool service, in the case of PSERS or any previous State or creditable nonstate service, in the case of SERS.

For the purposes of the Commission's discussion, the major issues of the new pension plans 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 the School Employees' Defined Contribution Plan and the State Employees' Defined Contribution Plan, establishes the PSERS and SERS Boards to administer or ensure the administration of the respective Plans, and sets forth the Boards' powers and duties. Most of the details governing the actual operation of the new Plans are delegated to the Boards which will be responsible for establishing the rules and regulations governing the Plans. These rules and regulations will presumably address the many specific details involved in the operation of a public pension plan. It also appears that most of the new Plans' investment and administrative functions may be handled by third-party administrators contracted by the Boards to provide the necessary services.

Coverage, Benefits and Contributions

School employees who participate in the new DC plan would contribute 7.50% of compensation with an employer contribution of 4% of compensation. Most State employees who participate in the new DC plan would contribute 6.25% of compensation with an employer contribution of 4% of compensation. For hazardous duty employees (including Capitol Police and park rangers), the employer contribution rate would be 5.5% of compensation. Future Pennsylvania State Police Officers and correction officers would be exempt from joining the new DC plan, with new employees of these groups continuing to be eligible for membership in SERS after 2015. Participation in the new DC plan for SERS would be mandatory for the following elected officials:

1) A current member of the General Assembly who is re-elected to the General Assembly or a new member of the General Assembly who is first elected on or after January 1, 2015;

2) A current member of the Judiciary who is retained as a member of the Judiciary, or a new member of the Judiciary who is first elected or nominated on or after January 1, 2015; and

3) The current Governor, Lieutenant Governor, Attorney General, Auditor General or Treasurer, who is re-elected to their respective office or a new statewide office-holder who is first elected on or after January 1, 2015.

A participant in the Plan may make additional contributions to the Plan up to the limits imposed by federal law. Contributions on behalf of the participant and the employer would be credited to an "individual investment account" for each participant of the new Plan, along with all interest and investment gains or losses. For investment purposes, the Board may pool the assets of the participants in the Plan.

A participant in the Plan would become fully vested in the employer-matching contributions after four years of employment (50% vested after 2 years and 75% vested after 3 years). The employee's contributions would vest immediately.

Investments

While the bill as amended does not specifically mention the type of investments that will be offered to the participants, governmental defined contribution plans typically offer a variety of investment options, including lifestyle funds that are based upon age and projected retirement date. The Plans will most likely also make available investment options that represent a broad cross-section of asset classes and risk profiles. The bill as amended states that the PSERS and SERS Boards will not be held responsible for any investment losses incurred by participants in the Plans or for the failure of any investment to earn a specific or expected return. The Boards will bear the expenses arising from the establishment of the Plans, but all other expenses, fees and costs of the administration of the Plans will be assessed against the accounts created on behalf of participants.

Ancillary Issues

Death and Disability Benefits. Beyond payment of the participant's account balance to the designated beneficiary upon the death of an active participant, there are no special death benefit provisions to provide for the surviving spouse or children of a Plan participant.

Premium Assistance. Under the PSERS Code, premium assistance eligibility is determined based upon years of service credited in the System. Because DC plan participants will no longer accrue service credit in the System, PSERS' DC plan participants would be ineligible for post-retirement health insurance premium assistance now provided to eligible retired members.

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. Because a participant in the Plan would not accrue credited service in the System, it is unclear how or if REHP participation would be incorporated into the DC 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. Under the bill as amended, the accumulated contributions of a participant shall not be forfeited but will be made available for payment of any fines or restitution.

Special Membership Classes

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, except for Pennsylvania State Police Officers and correction officers, there would be no special benefit provisions for these groups of employees in the new State Employees' DC plan.

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 is likely to be challenged in the courts.

There is also case law concerning altering the benefit provisions for members of the General Assembly or other State office-holders after being re-elected to office. In *Shiomos v. State Employees' Retirement Board,* 533 Pa. 558, 626 A. 2d 158 (1993), the Supreme Court held that a public official, at every new term of employment, renews his pension contract to include his new public service and to place at risk that which was already earned. A public official's re-election to office renews the official's employment contract subject to the law as it stands at the time the new term of office commences.[1]

[1] *Berkhimer v. State Employees' Retirement Board*, 2031 C.D. 2011

Treatment of Educational Employees

Under current law, "school employees" (employees of the Pennsylvania State System of Higher 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). Of the school employees who are eligible to choose membership in an alternative retirement program, approximately 50% elect membership in SERS, 45% elect membership in an alternative retirement program and 5% elect membership in PSERS. 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.

Under the bill as amended, eligible employees would continue to have the option of electing the alternative retirement plan rather than the new DC plans offered by either of the Systems. Since the alternative defined contribution plan offered to school employees would have an employer contribution rate more than twice the amount of what would be offered under the new DC plans, it's likely that most future eligible employees would choose the more attractive alternative plan.

Implications of Closing PSERS to New Members and Retention of a Vestigial DB Plan for SERS

As noted previously, membership in PSERS would be closed to school employees hired or returning after a break in service on or after July 1, 2015. In the case of SERS, only members of the Pennsylvania State Police or correction officers would remain eligible for membership in the System on or after January 1, 2015. Although SERS will be closed to most new members, SERS will maintain a vestigial DB plan containing State Police officers and correction officers. However, both PSERS and SERS 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 increased 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-percentage of compensation over 24 years for PSERS and on a level-dollar basis over a 30-year period for SERS. Changes due to legislative action are to be amortized over a ten-year period.

Under the bill as amended, for fiscal years beginning on or after July 1, 2014, for PSERS, any increase or decrease in the unfunded accrued liability will be amortized on a level-percentage of compensation of all active members and participants over a period of 24 years. Changes in the accrued liability of PSERS as a result of legislation will be amortized on a level-percentage of compensation over a ten-year period. In the case of SERS, for the fiscal year beginning July 1, 2015, any increase or decrease in the unfunded accrued liability will be amortized on a level-dollar basis as a percentage of compensation of all active members and participants over a period of 30 years. Beginning July 1, 2014, changes in the accrued liability of SERS due to benefit changes under the bill as amended will be amortized on a level-dollar basis over a period of 20 years.

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 24 or 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.

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.

Miscellaneous Provisions

Amendment Number 02498. Under Act 120 of 2010, the methods used to determine the employer contribution requirements for both PSERS and SERS were modified 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, Act 120 established 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 is 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, Act 120 limits 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 it is written, the bill would further modify the collars for PSERS only to further limit the rate at which the employer contributions may rise from year to year. For the fiscal years beginning July 1, 2013, July 1, 2014, July 1, 2015, July 1, 2016, July 1, 2017, and on or after July 1, 2018, the bill would establish a temporary collared contribution rate, that if the contribution rate is more than 2.25%, 2.75%, 3.25%, 3.75%, 4.25% 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 the prior year's final contribution rate plus the respective percentage of total compensation for all active members.

Amendment Number 02498 would remove the language in the bill further modifying the employer contribution collar for PSERS to restore the funding collars previously established under Act 120 of 2010.

Contractual Benefit Rights of DC Plan Participants. Section 401 of Article 4 in the bill explicitly states that a participant in either the School Employees' Defined Contribution Plan or the State Employees' Defined Contribution Plan shall not have "an express or implied contractual right" in relation to requirements for any of the following provisions: 1) Spousal consent; 2) Qualification of the Plans as a qualified plan(s) under the Internal Revenue Code; 3) Contributions to, participation in, or benefits from the Plans; and 4) Domestic relations orders regarding alternate payees of participants in the Plans.

Judicial Review. Section 408 of Article 4 in the bill includes an unusual provision that would require all legal challenges to the constitutionality of the bill to be heard and decided by a special tribunal consisting of seven randomly selected senior lower court judges, empanelled by the Pennsylvania Supreme Court.

SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill, Amendment Number 02498, the actuarial cost estimate provided to the Commission by Buck Consultants, the consulting actuary for PSERS (see attachments), and the actuarial cost estimate provided to the Commission by Hay Group, the consulting actuary for SERS (see attachments). On Friday, June 21, 2013, and June 25, 2013, the Commission also received certain actuarial work prepared by Milliman, Inc. for the Office of the Budget (all referenced materials, including the work of the Commission's consulting actuary, Cheiron, are attached). The following summarizes the views of the Commission's consulting actuary.

Implications of Closing the Systems to New Entrants.

The bill closes the defined benefit plans to future members of PSERS and to most future members of SERS (State Police and correction officers are exempt). Any anticipated cost savings under the bill as amended may be offset by the closing or contraction of the defined benefit systems. The implications of a decreasing contribution stream and an increasing benefit payout stream of a closed plan changes the risks of financing these benefits over time.

Funding projections prepared by the Systems' actuaries show that under the current plan designs, contributions for both Systems reach a high of approximately 30% of payroll over the course of their projections based on the current assumptions. While Act 120 significantly reduced the benefits for members hired after June 30, 2011 for PSERS and December 31, 2010 for SERS, the costs for these members are relatively low, approximately 2.85% of payroll for PSERS and 5.00% of payroll for SERS. The cost reduction will be emerging slowly through expected replacement of active members. Therefore, what is driving the costs of the Systems is the funding of the unfunded actuarial liability. This is because the unfunded actuarial liability of the Systems will need to be paid off even if the plans are closed to new members.

While the move from a defined benefit to a defined contribution plan transfers the portion of future benefit financing anticipated to be derived from investment returns, it will take a significant period of time before that risk transfer materially reduces the funding obligations. In the meantime, the higher risks to the closed defined benefit plans may result in higher and more volatile costs.

It can be anticipated that financing benefits for the same participants in a closed plan through contributions will be greater than for the same participants in an open plan because of the decreasing working life of active employees and the ever decreasing period for recovery from market volatility. This will likely lead to the need for more conservative assumptions and result in overall higher costs. Therefore, in a closed plan, it is reasonable to expect lower investment returns on assets needed to meet increasingly shorter term obligations as time goes on. Using a lower investment return to value the plan's obligations will result in a higher liability and higher contributions.

As PSERS matures over time as a closed plan, there will be a higher risk associated with asset smoothing methods for funding volatility management. Ten-year smoothing with a 30 percent corridor around market value may not provide enough protections against the potential risks of insolvency. Either a tighter corridor or shorter smoothing method may need to be considered over time if not immediately.

The Commission's consulting actuary concluded that the modifications to the long-term interest rates and amortization periods used in the Hay analysis were reasonable. However, Hay Group did not provide an analysis of how they arrived at the interest rate structure. The Commission's consulting actuary suggests that Hay Group and SERS seek advice from the SERS' investment consultant on the most appropriate interest rate structure, given the System's projected liquidity needs.

It is reasonable to assume that long-term investment return experience will be lower under a closed plan. The interest rate assumption used by Buck Consultants for valuing PSERS liabilities was provided by Wilshire, PSERS' investment consultant, and was based on: i) future expected benefit commitments; ii) an investment horizon which covers fiscal years 2013 through 2046; iii) the illiquidity of certain investment classes; and iv) expected reduction of risk and surplus volatility over the period to minimize employer contribution requirements while securing assets for benefit commitments.

Cheiron was provided with copies of work prepared by Milliman, Inc. for the Office of the Budget. In their work product, Milliman acknowledges that, in the future, the investment rate of return assumption will need to be lowered due to increased liquidity requirements resulting from closure of the defined benefit plan. However, Milliman asserts that the investment rate of return does not need to be lowered during the projection period because the liquidity requirements of the Systems will not materially change during that period. Milliman bases their liquidity analysis on a "liquidity ratio" defined as the expected benefit payments in the upcoming year divided by the market value of assets. The Commission's consulting actuary does not consider this method to be an appropriate measure of liquidity since not all of the Systems' assets are liquid. Milliman should consider comparing the contributions coming into the Systems to the benefit payments and whether there is a negative cash flow.

Desirability of Further Analysis.

The Commission's consulting actuary has concluded that the cost estimate prepared by Buck Consultants and Hay Group reflect only a single alternative analysis of the implications of future investment returns and amortization periods. The Commission's consulting actuary has indicated that a more robust analysis using multiple scenarios or a stochastic analysis that measures the sensitivity of the Systems, the magnitude of the potential future cost and future implications would be more valuable to policymakers in understanding the implication of the additional risk the bill presents to the long-term solvency of the Systems, relative to the sustainable level of potential costs.

Governmental Accounting Board Statements Number 67 and 68.

Finally, many of these issues may also become significant regardless of the Systems' or the Commonwealth's funding policies because of the new reporting obligations under Governmental Accounting Standards Board (GASB) statement number 67 and 68, which will require more rapid recognition of changes in the net unfunded liability and the reporting of these amounts on the Commonwealth's balance sheet. So while the current methods may act to defer the funding obligations, the new accounting standards will require full recognition of the unfunded liabilities in the Commonwealth's financial statements.

POLICY CONSIDERATIONS

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

<u>Benefit Value and Security</u>. While a detailed benefit comparison was beyond the scope of this actuarial note, the DC plans proposed in the bill as amended would provide new public school and State employees and employees returning after a break in service with a retirement income that is likely to be less valuable, predictable and secure than that provided by the traditional DB pension plans. 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.

<u>Delegation of Legislative Authority</u>. The bill as amended empowers the Boards of both Systems to develop the details of major DC plan design elements and administrative details by rule or regulation. The General Assembly and the Governor must determine if the broad powers afforded the Boards constitutes an appropriate delegation of legislative authority.

<u>Special Membership Classes</u>. 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, except for Pennsylvania State Police Officers and correction officers, there are no special benefit provisions for these groups of employees. The uniform benefit level under the bill as amended 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.

<u>Judicial Benefits</u>. 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 is likely to be challenged in the courts.

State Police and Correction Officers Benefits. The benefits of State Police officers are affected by the DiLauro arbitration award. The award provided that officers with 20 years of service are eligible to receive a retirement benefit of 50% of the officer's highest full year's salary, and those with 25 years of service shall receive 75% of the highest full year's salary. Years of service between 20 and 25 or after 25 do not produce incremental benefit increases. The award applies to officers who retire on or after July 1, 1989. (Class A members with less than 20 years of service are not affected by the award and are eligible for the statutory Class A benefit at a 2.0% benefit accrual rate. No State Police officer is entitled to the Act 9 benefit accrual rate of 2.5% because members of the State Police were specifically excluded from coverage by that statute). By the act of August 5, 1991 [P. L. 183, No. 23], 71 Pa. C. S. § 5955 was amended to provide that SERS retirement benefits are exclusively statutory and cannot be changed by collective bargaining agreements or arbitration awards under such agreements. That section grandfathered pre-existing awards, including DiLauro, but the amendment does not foreclose the legislature from prospectively altering benefits for new State Police officers by statute. It is unclear why State Police and correction officers are given special treatment in the bill while other traditional, special membership classes are not exempt from the new DC plan.

Renewal of Pension Contract. In *Shiomos v. State Employes' Retirement Board,* 533 Pa. 588, 626 A.2d 158 (1993), the Supreme Court held that a public official, at every new term of office, renews his pension contract subject to the law in effect when the new term of office commences. While this case, and the subsequent decisions that follow its holding, specifically relates to Section 3 of the Public Employee Pension forfeiture Act, 1978, July 8, P. L. 752, No. 140, 43 P.S. § 1313(c), the core of the court's analysis is that a statutory provision can alter otherwise protected benefits contingent upon a change in the nature of the employment. That analysis may apply equally to the statutory amendment proffered by this legislation.

Technical Operational Issues. In reviewing the bill as amended, the Commission staff noted the following technical operational issues.

Closed Group Funding Dynamics. The bill as amended would close both PSERS and SERS to new entrants effective 2015 (except for Pennsylvania State Police Officers and correction officers, in the case of SERS), substituting membership in the Systems with participation in DC plans for new employees and employees returning after a break in service. In their respective work products, the consulting actuaries for both PSERS and SERS describe the major issues associated with the funding dynamics of a defined benefit retirement system that has been closed to new entrants. The use of level percentage of payroll amortization periods, amortization periods that exceed the average remaining service of active members, and the manner in which investment return assumptions are set by the respective retirement system boards will all require review and adjustment if the bill becomes law. Generally, shorter amortization periods combined with reductions in investment return assumptions in order to ensure liquidity to pay benefits when due would have the effect of increasing employer contribution requirements.

Nondiscrimination Provision. As the existing defined benefit plan gradually loses active members other than members of the State Police and correction officers (and probably judges), the risk of violating the nondiscrimination provisions and participation requirements of the Internal Revenue Code, Sections 401(a)(4) and (26), and 414, is likely to develop. These issues should be reviewed by qualified tax counsel.

Premium Assistance. Under the PSERS Code, premium assistance eligibility is determined based upon years of service credited in the System. Because DC plan participants will no longer accrue service credit in the System, PSERS' DC plan participants would be ineligible for post-retirement health insurance premium assistance now provided to eligible retired members.

*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. Because a participant in the Plan would not accrue credited service in the System, it is unclear how, or if, REHP participation would be incorporated into the DC plan.

Employee Contributions. The bill as amended would mandate employee contribution requirements that are inconsistent and would result in benefit inequities between and among school and State employees, resulting in certain members contributing a greater percentage of compensation for apparently the same level of benefits. School employees will contribute 7.5% to the new defined contribution plan, while most State employees will contribute 6.25%. There are no other differences between the two defined contribution plans. The rationale for setting the differing employee contribution requirements is unclear.

Risk Sharing. Under the defined benefit structure of PSERS and SERS, all of the longevity risk (the risk of members outliving their retirement income) and most of the investment risk is borne by the retirement systems. Under current law, only those members subject to Act 120 of 2010 (Classes A-3, A-4, T-E and T-F) share in the investment risk of the Systems through the shared-risk contribution requirement imposed by Act 120. All pre-Act 120 members of both Systems are exempt from the shared-risk contribution requirement. Under the bill, all new employees would be enrolled in a DC plan and would be required to bear all of the investment risk and longevity risk associated with managing their retirement accounts. This situation creates significant risk-sharing disparities among various cohorts of employees.

COMMISSION RECOMMENDATION

On June 25, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

Senate Bill Number 922, Printer's Number 1252, had second consideration on June 20, 2013, and was re-referred to the Senate Appropriations Committee.

To view this note in its entirety, click the following link: Senate Bill Number 922, Printer's Number 1252, as amended by Amendment 02498

Bill ID: House Bill Number 546, Printer's Number 580

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

Subject: New Benefit Tier

SYNOPSIS

House Bill Number 546, Printer's Number 580, would amend the act of July 28, 1953, P. L. 723, No. 230, known as the Second Class County Code (Code), by establishing a new mandatory benefit tier applicable to county employees hired on or after the effective date of the bill. The bill would also amend Section 1703 of the Code by altering the membership composition of the Allegheny County Retirement Board, and would make technical amendments to the plan intended to ensure that the Allegheny County Employees' Retirement System is maintained as tax qualified under the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 401 (c)).

More specifically, the bill would amend the Code to make the following benefit modifications for employees hired on or after the effective date of the bill:

1) For nonuniformed employees, increase the length of service required to receive normal retirement benefits from 20 years to 25 years, while retaining age 60 normal retirement age;

2) For public safety employees, increase the length of service required to receive normal retirement benefits from 20 years to 25 years, while retaining age 50 normal retirement age for police officers and firefighters, and age 55 normal retirement age for the county sheriff, deputy sheriffs, prison guards and probation officers;

3) Increase the length of service required for vesting from 8 years to 10 years for all classes of employees;

4) For retirement benefit purposes, extend the period over which the final average salary is calculated from the highest 24 months of the last four years of employment to the highest 48 months of the last eight years of employment, or the last four years of employment if compensated on a bi-weekly basis; and

5) Increase the length of service required to receive service increment benefits from 20 years to 25 years;

6) Increase the length of service required to be eligible for early retirement from eight years to ten years;

7) Increase the length of service required to be eligible for survivor benefits from eight years to ten years;

8) Increase the length of service required to be eligible for survivor benefits under disability retirement from 20 years to 25 years;

9) Amend Section 1701 by altering the definition of "compensation" to eliminate overtime compensation from the retirement benefit calculation.

Article 17 of the Second Class County Code (Code) provides the pension plan for employees of Allegheny County. The Allegheny County Retirement System (System) is a governmental, defined benefit pension plan. Membership in the System is mandatory for county employees. As of January 1, 2012, there were 7,408 active members of the System with an annual payroll of approximately $329 million. Under the Code, the normal retirement benefit is equivalent to 50 percent of the member's final average salary. The final average salary is calculated as the monthly average of the highest 24 months of compensation earned during the last 48 months of service prior to retirement.

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

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

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

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

Special retirement benefit coverage is provided to the various types of public safety employees who are employed by Allegheny County. The special coverage provided to the county sheriff, deputy sheriffs, prison guards and probation officers employed by the county is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 55 and has accumulated at least 20 years of service. The special coverage provided to firefighters and police officers is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 50 and has at least 20 years of service. The regular coverage provided to all other employees of the county is to retire voluntarily and receive a normal retirement benefit if the employee has attained age 60 and has at least 20 years of service. The bill would amend the requirements to receive normal retirement benefits by increasing the length of service required to receive normal retirement benefits from 20 years to 25 years of service, while retaining age 50 normal retirement age for police officers and firefighters, age 55 normal retirement age for the county sheriff, deputy sheriffs, prison guards and probation officers, and age 60 normal retirement age for all other employees.

Certain early retirement benefit options are also available to employees of Allegheny County. Under early retirement “Option I" (section 1710(h)(1)), any county employee who has completed at least eight, but less than 20, years of service may retire voluntarily and receive a deferred benefit commencing at age 60. Alternatively, under “Option II” (section 1710(h)(2)), an employee who has accumulated at least eight, but less than 20, years of service and is at least age 55, but less than age 60, may elect to receive an early retirement benefit that is actuarially reduced by one-half of one percent for each month the employee is under age 60.

The bill would establish two additional early retirement options, “Option I-A” and “Option II-A,” applicable only to county employees hired on or after the effective date of the bill. Under early retirement Option I-A (section 1710(h)(1.1)), any county employee who has completed at least ten, but less than 25, years of service may retire voluntarily and receive a deferred benefit commencing at age 60. Alternatively, under Option II-A (section 1710(h)(2.1)), an employee who has accumulated at least ten, but less than 25, years of service and is at least age 55, but less than age 60, may elect to receive an early retirement benefit that is actuarially reduced by one-half of one percent for each month the employee is under age 60.

In addition to the normal retirement benefit provided by the System, any county employee who retires with more than 20 years of service is eligible to receive a service increment of two percent per year (computed upon the annual retirement allowance to which the employee is entitled) for each completed year of service beyond 20 years. No service increment is paid for more than 20 years of “excess” service. Under the bill, any county employee hired on or after the effective date of the bill who retires with more than 25 years of service would be eligible to receive a service increment of two percent per year for each completed year of service beyond 25 years. The service increment benefit would continue to be limited to no more than 20 years of “excess” service.

Currently, a county employee may elect to provide survivor benefits for a spouse. Survivor benefits may be provided to the surviving spouse of a deceased employee upon the condition that the employee had attained age 50 and completed at least eight, but less than 19, years of service in order for a surviving spouse to be eligible for a reduced retirement option benefit at the time the deceased spouse would have reach aged 55. For employees who complete 20 or more years of service and die before reaching age 50, the surviving spouse is eligible to immediately receive a reduced retirement option. For county employees hired on or after the effective date of the bill, survivor benefits may be provided to the surviving spouse of a deceased employee upon the condition that the employee had attained age 50 and completed at least ten, but less than 24, years of service and died before reaching age 55. A reduced retirement option benefit would be provided to the surviving spouse at the time the deceased spouse would have reached age 55. For an employee who completed 25 or more years of service and died before reaching age 50, the surviving spouse would be eligible to immediately receive a reduced retirement option.

Currently, a county employee retiring under disability retirement can qualify for survivor benefits if the employee has reached age 55 and completed 20 or more years of service. The employee would be eligible for the same benefits as if retiring under normal retirement. A county employee retiring under disability with at least twelve, but less than 20, years of service is eligible upon reaching age 55 for survivor benefits. The surviving spouse receives a maximum amount of $75 per month upon the deceased spouse’s death. Under the bill, any county employee hired on or after the effective date of the bill and retiring under disability retirement would qualify for survivor benefits if the employee has reached age 55 and completed 25 or more years of service. The employee would be eligible for the same benefits as if retiring under normal retirement. Any county employee retiring under disability retirement with at least twelve, but less than 25, years of service would be eligible upon reaching age 55 for survivor benefits. The surviving spouse would receive a maximum amount of $75 per month upon the deceased spouse's death.

Comparison of Benefits for Current Employees and Future Employees After the Effective Date of the Bill

	Current Employees	Future Employees
Eligibility Requirements for Normal Retirement	**Non-Uniformed:** Age 60 and 20 years of service **Police & Firefighters:** Age 50 and 20 years of service **Sheriffs, Deputies, Prison Guards & Probation Officers:** Age 55 and 20 years of service	**Non-Uniformed:** Age 60 and 25 years of service **Police & Firefighters:** Age 50 and 25 years of service **Sheriffs, Deputies, Prison Guards & Probation Officers:** Age 55 and 25 years of service
Benefit Accrual Per Year of Service	1/20th of normal retirement benefit	1/25th of normal retirement benefit
Service Increment Benefit	2.0% of annual retirement allowance for years of service between 20 and 40 years	2.0% of annual retirement allowance for years of service between 25 and 45 years
Vesting	100% after 8 years of service	100% after 10 years of service
Early Retirement	After 8 years but less than 20 years of service	After 10 years but less than 25 years of service
Compensation	Includes overtime pay	Excludes overtime pay
Average Monthly Compensation for Benefit Purpose	Highest 24 months of the last 4 years of employment or 2 years of employment on a bi-weekly pay basis	Highest 48 months of the last 8 years of employment or 4 years of employment on a bi-weekly pay basis

SUMMARY OF ACTUARIAL COST IMPACT

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

Years After Effective Date of House Bill No. 546	Decrease in Normal Cost	Decrease in Normal Cost as Percentage of January 1, 2012, Active Payroll
5	$ 2,440,000	0.74%
10	$ 5,894,000	1.79%
15	$10,435,000	3.17%
20	$16,567,000	5.03%

Under current law, a typical county employee retiring at age 60 with 20 years of service would receive a monthly retirement benefit of $1,844. Under the bill, a typical future county employee working the same number of years and retiring at the same age would receive a monthly retirement benefit of $1,425. This would amount to a benefit reduction of 22.7% for future employees. However, if a future county employee was to work five years longer, for a total of 25 years of service and retire at age 60, the monthly retirement benefit would improve to $1,781 (compared to $2,028 for a current county employee), a benefit reduction of 12.2% compared to a current county employee.

POLICY CONSIDERATIONS

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

Reduction in Normal Cost. The bill would amend the definition of compensation applicable to all county employees hired on or after the effective date of the bill, to preclude the inclusion of overtime in the calculation of a member's retirement benefit. The bill would also mandate a less generous final average salary calculation applicable to newly hired county employees. Although these changes would do nothing to reduce the liabilities attributable to the benefit accruals of current active members, together they would have the effect of reducing the normal cost associated with the retirement benefit accruals of future employees.

Reduced Benefit Tier. If enacted, the bill's elimination of overtime compensation from the retirement benefit formula, combined with the implementation of a less generous final average salary calculation, would have the effect of functioning as a reduced benefit tier applicable to new employees of the county.

Retirement Board Composition. The bill would amend Section 1703 of the Code to alter the composition of the Allegheny County Retirement Board by replacing certain elected officials with appointed county officials. The General Assembly must determine whether it is appropriate to replace the elected officials with appointed officials.

COMMISSION RECOMMENDATION

On March 8, 2013, 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.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

A later version of House Bill Number 546 was signed into law by the Governor on December 23, 2013.

To view this note in its entirety, click the following link: House Bill Number 546, Printer's Number 580

Bill ID: House Bill Number 1352, Printer's Number 1846, as amended by Amendment Numbers 02189 and 02191

System: Public School Employees' Retirement System

Subject: Defined Contribution Retirement Plan

SYNOPSIS

House Bill Number 1352, Printer's Number 1846, would amend Title 24 (Public School Employees' Retirement Code) to:

1) Add a new chapter, Chapter 84, titled "School Employees' Defined Contribution Plan." Chapter 84 would establish a mandatory defined contribution plan for public school employees whose most recent period of public school service starts on or after July 1, 2015. Employer contributions to the plan would be equal to 4% of salary, with a mandatory employee contribution of 4% of salary; and

2) Permit current PSERS members to elect to participate in the defined contribution plan prospectively, with a 4% employer contribution and 4% employee contribution for all subsequent school service.

Amendment Number 02189 would amend the bill to:

1) Modify the calculation of "final average salary" applicable to current PSERS members from the average of the highest three years of service to the average of the highest five years for all service performed or first credited on or after July 1, 2015; and

2) For service performed or credited to current members on or after July 1, 2015, further limit pensionable compensation to not exceed 110% of the average of the four preceding years of pensionable compensation for final average salary calculation purposes.

Amendment Number 02191 would amend the bill to:

1) For current members of the System who elect the Option 4 lump-sum withdrawal upon retirement after July 1, 2015, modify the manner of determining the net annuity to make the option actuarially cost neutral to the System for all employee contributions made after the year 2015.

DISCUSSION

The Retirement Code and System

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. As of June 30, 2012, there were approximately 773 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS.

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, 2012, there were 273,504 active members and 202,015 annuitant members of PSERS.

For most members of the System, 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. Within PSERS, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school employees.

Act 120 of 2010 implemented major pension reform that affected the System, including the establishment of new benefit tiers applicable to most new members. Effective July 1, 2011, new members of PSERS are required to become members of one of two membership classes, known as "Class T-E" and "Class T-F." Most new members of PSERS are required to become members of Class T-E beginning July 1, 2011. Class T-E members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution of 7.5% of compensation. As an alternative to Class T-E, an employee who becomes a member of PSERS on or after July 1, 2011, may elect Class T-F membership within 45 days of becoming a member of PSERS. A Class T-F member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 10.3% of compensation.

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. For most members of PSERS who first became members after the effective date of Act 120, the superannuation requirement is age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 with at least 35 years of credited service.

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, 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 plan proposed in the bill for new or returning school employees, 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 entail 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 as employees approach retirement age.

Defined Contribution Plan for School Employees

The bill would establish a new mandatory governmental retirement plan, known as the School Employees' Defined Contribution Plan ("Plan"), for all new school employees or employees returning after a break in service on or after the year 2015. The defined benefit plan provided by PSERS would be closed to new entrants or returning employees effective July 1, 2015.

Current members of PSERS would retain membership in the System unless they choose to become a "participant" in the new DC plan, at which point they would cease accruing service credit in PSERS. Membership benefits already accumulated prior to election in the DC plan would be frozen in the System, but available to the employee upon retirement. Election to participate in the plan can be made at any time, and would be an irrevocable election. An employee who is both a member of the System and a participant in the plan would be known as a "combined service employee." After electing to participate in the Plan, the employee would be prohibited from purchasing any previous school or creditable nonschool service. Under Section 8306 of the bill, for an active member who elects to become a participant in the Plan, vesting requirements under the System (five-year vesting for Class T-D and ten-year vesting for Classes T-E & T-F) shall be considered to have been satisfied if the employee participates in the Plan for three or more years. A combined service employee would also be eligible for a superannuation annuity only after either attaining superannuation age or having a superannuation score of 92 (age plus years of service). Section 8307 of the bill states that only years of service that were actually accrued as a member of the System prior to election in the plan would be counted towards the superannuation score.

For the purposes of the Commission's discussion, the major issues of the new pension plan 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 mandates the creation of the School Employees' Defined Contribution Plan, establishes the PSERS Board as administrator of the Plan, and sets forth the Board's powers and duties. Most of the details governing the actual operation of the new Plan are delegated to the Board which will be responsible for establishing the rules and regulations governing the Plan. These rules and regulations will presumably address the many specific details involved in the operation of a public pension plan. It also appears that most of the new Plan's investment and administrative functions may be handled by third-party administrators contracted by the Board to provide the necessary services.

Coverage, Benefits and Contributions

School employees who participate in the new DC plan would be required to contribute a mandatory 4% of compensation with an employer-matching contribution of 4% of compensation. A participant may make additional contributions to the pension plan up to the limits imposed by federal law. Contributions on behalf of the participant and the employer would be credited to an "individual investment account" for each participant of the new Plan, along with all interest and investment gains or losses. For investment purposes, the Board may pool the assets of the participants in the Plan.

Participants in the Plan would be 100% vested immediately in all employee and employer contributions, as well as any interest and earnings attributed to those contributions.

Investments

While the bill does not specifically mention the type of investments that will be offered to the participants, governmental defined contribution plans typically offer a variety of investment options, including lifestyle funds that are based upon age and projected retirement date. The Plan will most likely also make available investment options that represent a broad cross-section of asset classes and risk profiles. The bill states that the PSERS Board will not be held responsible for any investment losses incurred by participants in the Plan or for the failure of any investment to earn a specific or expected return. All fees, costs and expenses of administering the Plan will be assessed against the accounts created on behalf of participants.

Ancillary Issues

Death and Disability Benefits. Beyond payment of the participant's account balance to the designated beneficiary upon the death of an active participant, there are no special death or disability benefit provisions to provide for the surviving spouse or children of a Plan participant.

Premium Assistance. Under the PSERS Code, premium assistance eligibility is determined based upon years of service credited in the System. Because DC plan participants will no longer accrue service credit in the System, PSERS' DC plan participants would be ineligible for post-retirement health insurance premium assistance now provided to eligible retired members.

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. Under the bill, the accumulated contributions of a participant shall not be forfeited but will be made available for payment of any fines or restitution.

Limitations on Compensation and Final Average Salary

Amendment Number 02189 proposes two new limits on compensation that may be used for purposes of calculating the retirement benefits of active members of PSERS. The changes proposed are: 1) increasing the period over which the member's final average salary may be calculated from three years to five years; and 2) imposing the "New York Rule" for averaging. The overall impact will be to reduce from current benefit levels the potential future retirement benefits of the affected members.

The System currently employs a member's "final average salary" as one of the components of the statutory formula that is used to compute a member's retirement benefit entitlement. Currently, a member's final average salary is calculated as the average of the highest three years of compensation. The amendment to the bill would amend the Code to change the final average salary calculation from the average of the highest three to the average of the highest five years of compensation for all prospective school service credited on or after July 1, 2015. All service performed and credited prior to the year 2015 would retain the three-year final average salary calculation. A new final average salary calculation at the time of retirement would include two components; both the final average salary using the three-year average for all service performed and credited prior to the year 2015, combined with the final average salary calculated over the highest five years of school service for all service credited after the year 2015.

The amendment to the bill would apply a new limit on the level of compensation that may be used for final average salary determination purposes, known as the "New York Rule." Under this provision, the pensionable compensation cannot exceed 110% of the average of the four preceding years.

Members' Retirement Options

The maximum single-life annuity is the basic retirement benefit entitlement for members of PSERS. 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 PSERS' Retirement Code provides 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. Retirement Option 4 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 Act 120 of 2010, the election to withdraw the member's accumulated deductions under Option 4 was 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 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.

Under the bill, the election to withdraw the member's accumulated deductions under Option 4 would remain available to current members of PSERS. However, Amendment Number 02191 would implement a change in the manner in which the Option 4 withdrawal is computed to make Option 4 actuarially cost neutral to the System for all service credited after the year 2015. For all service performed and credited before the year 2015 by current active members of the System, the accumulated deduction calculation will remain unchanged.

Potential Contract Impairment

By altering the benefit provisions for members in PSERS on or after July 1, 2015, it appears that the bill and amendments may impair the retirement benefit rights of active members of the System. Historically, 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).[1] *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).

Implications of Closing PSERS to New Members

As noted previously, membership in PSERS would be closed to all new employees or employees returning after a break in service on or after the year 2015. However, the retirement system will retain its 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 System's 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. The System currently has a large unfunded actuarial accrued liability that will need to be covered by future contributions. The liabilities of PSERS 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 is 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 increased 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-percentage of compensation over 24 years for PSERS. Changes due to legislative action are to be amortized over a ten-year period.

---

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

Under the bill, for fiscal years beginning July 1, 2014, any increase or decrease in the unfunded accrued liability will be amortized on a level-percentage of compensation of all active members and participants over a period of 24 years. Changes in the accrued liability of PSERS as a result of legislation will be amortized on a level-percentage of compensation over a ten-year period.

As the active membership declines within the System, it may not be reasonable to assume that future changes in the unfunded accrued liability should be amortized over 24 years on a level percentage of payroll basis. 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.

Once active membership in PSERS has significantly declined and retired members are the majority of the System's total membership, the System may also need to consider revising its investment policies. Due to the need to ensure sufficient liquidity to provide for the payment of benefits, PSERS 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, the amendments, and the actuarial cost estimate provided to the Commission by Buck Consultants, the consulting actuary for PSERS (see attachments). On Friday, June 21, 2013, the Commission also received certain actuarial work prepared by Milliman, Inc. for the Office of the Budget (all referenced materials, including the work of the Commission's consulting actuary, Cheiron, are attached). The following summarizes the views of the Commission's consulting actuary.

Implications of Closing the System to New Entrants.

The bill closes the defined benefit plan to future members. Any anticipated cost savings under the bill as amended may be offset by the closing of the defined benefit system. The implications of a decreasing contribution stream and an increasing benefit payout stream of a closed plan changes the risks of financing these benefits over time.

While the move from a defined benefit to a defined contribution plan transfers the portion of future benefit financing anticipated to be derived from investment returns, it will take a significant period of time before that risk transfer materially reduces the funding obligations. In the meantime, the higher risks to the closed defined benefit plans may result in higher and more volatile costs.

It can be anticipated that financing benefits for the same participants in a closed plan through contributions will be greater than for the same participants in an open plan because of the decreasing working life of active employees and the ever decreasing period for recovery from market volatility. This will likely lead to the need for more conservative assumptions and result in overall higher costs. Therefore, in a closed plan, it is reasonable to expect lower investment returns on assets needed to meet increasingly shorter term obligations as time goes on. Using a lower investment return to value the plan's obligations will result in a higher liability and higher contributions.

As the System matures over time as a closed plan, there will be a higher risk associated with asset smoothing methods for funding volatility management. Ten year smoothing with a 30 percent corridor around market value may not provide enough protections against the potential risks of insolvency. Either a tighter corridor or shorter smoothing method may need to be considered over time if not immediately.

It is reasonable to assume that long-term investment return experience will be lower under a closed plan. The interest rate assumption used by Buck Consultants for valuing PSERS liabilities was provided by Wilshire, PSERS' investment consultant, and was based on: i) future expected benefit commitments; ii) an investment horizon which covers fiscal years 2013 through 2046; iii) the illiquidity of certain investment classes; and iv) expected reduction of risk and surplus volatility over the period to minimize employer contribution requirements while securing assets for benefit commitments.

Cheiron was provided with copies of work prepared by Milliman, Inc. for the Office of the Budget. In their work product, Milliman acknowledges that, in the future, the investment rate of return assumption will need to be lowered due to increased liquidity requirements resulting from closure of the defined benefit plan. However, Milliman asserts that the investment rate of return does not need to be lowered during the projection period because the liquidity requirements of the System will not materially change during that period. Milliman bases their liquidity analysis on a "liquidity ratio" defined as the expected benefit payments in the upcoming year divided by the market value of assets. The Commission's consulting actuary does not consider this method to be an appropriate measure of liquidity since not all of the System's assets are liquid. Milliman should consider comparing the contributions coming into the System to the benefit payments and whether there is a negative cash flow.

***Desirability of Further Analysis*.**

The Commission's consulting actuary has concluded that the cost estimate prepared by Buck Consultants reflects a single alternative analysis of the implications of future investment returns and amortization periods. The Commission's consulting actuary has indicated that a more robust analysis using multiple scenarios or a stochastic analysis that measures the sensitivity of the System, the magnitude of the potential future cost and future implications would be more valuable to policymakers in understanding the implication of the additional risk the bill presents to the long-term solvency of the System, relative to the sustainable level of potential costs.

Governmental Accounting Board Statements Number 67 and 68.

Finally, many of these issues may also become significant regardless of the System's or the Commonwealth's funding policies because of the new reporting obligations under Governmental Accounting Standards Board (GASB) statement number 67 and 68, which will require more rapid recognition of changes in the net unfunded liability and the reporting of these amounts on the Commonwealth's balance sheet. So while the current methods may act to defer the funding obligations, the new accounting standards will require full recognition of the unfunded liabilities in the Commonwealth's financial statements.

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

Potential Contract Impairment. Historically, 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). As written, the active member benefit modifications proposed in the amendments may be found to impair the benefit rights of the affected active members.

Benefit Value and Security. While a detailed benefit comparison was beyond the scope of this actuarial note, the DC plan proposed in the bill would provide new public school employees and employees returning after a break in service with a retirement income that is likely to be less valuable, predictable and secure than that provided by the traditional DB pension plan. 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.

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

Technical Operational Issues. In reviewing the bill and amendments, the Commission noted the following technical operational issues.

Closed Group Funding Dynamics. The bill would close PSERS to new entrants effective 2015, substituting membership in the System with participation in a DC plan for new employees and employees returning after a break in service. In its work product, the consulting actuary for PSERS describes the major issues associated with the funding dynamics of a defined benefit retirement system that has been closed to new entrants. The use of level percentage of payroll amortization periods, amortization periods that exceed the average remaining service of active members, and the manner in which investment return assumptions are set by the retirement system board will all require review and adjustment if the bill becomes law. Generally, shorter amortization periods combined with reductions in investment return assumptions in order to ensure liquidity to pay benefits when due would have the effect of increasing employer contribution requirements.

Premium Assistance. Under the PSERS Code, premium assistance eligibility is determined based upon years of service credited in the System. Because DC plan participants will no longer accrue service credit in the System, PSERS' DC plan participants would be ineligible for post-retirement health insurance premium assistance now provided to eligible retired members.

Risk Sharing. Under the defined benefit structure of PSERS, all of the longevity risk (the risk of members outliving their retirement income) and most of the investment risk is borne by the retirement system. Under current law, only those members subject to Act 120 of 2010 (Classes T-E and T-F) share in the investment risk of the System through the shared-risk contribution requirement imposed by Act 120. All pre-Act 120 members of the System are exempt from the shared-risk contribution requirement. Under the bill, all new employees would be enrolled in a DC plan and would be required to bear all of the investment risk and longevity risk associated with managing their retirement accounts. This situation creates significant risk-sharing disparities among various cohorts of employees.

COMMISSION RECOMMENDATIONS

On June 25, 2013, the Commission voted to attach the actuarial notes to the bill and amendments, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

A later version of House Bill Number 1352 had first consideration on June 25, 2013, and was re-referred to the House Rules Committee.

To view this note in its entirety, click the following link: House Bill Number 1352, Printer's Numbers 1846, as amended by Amendment Numbers 02189 and 02191

Bill ID: House Bill Number 1353, Printer's Number 1847, as amended by Amendment Numbers 02204 and 02259

System: State Employees' Retirement System

Subject: Defined Contribution Retirement Plan

SYNOPSIS

House Bill Number 1353, Printer's Number 1847, would amend Title 71 (State Employees' Retirement Code) to:

1) Add a new chapter, Chapter 54, titled "State Employees' Defined Contribution Plan." Chapter 54 would establish a mandatory defined contribution plan for state employees whose most recent period of state service starts on or after January 1, 2015. Employer contributions to the plan would be equal to 4% of salary for most employees, with a mandatory employee contribution of 4% of salary; and

2) Permit current SERS members to elect to participate in the defined contribution plan prospectively, with a 4% employer contribution and 4% contribution for all subsequent state service.

Amendment Number 02204 would amend the bill to:

1) For current members of the System who elect the Option 4 lump-sum withdrawal upon retirement after January 1, 2015, modify the manner of determining the net annuity to make the option actuarially cost neutral to the System for all employee contributions made after the year 2015.

Amendment Number 02259 would amend the bill to:

1) Modify the calculation of "final average salary" applicable to current SERS members from the average of the highest three years of service to the average of the highest five years for all service performed or first credited on or after January 1, 2015.

2) For service performed or credited to current members on or after January 1, 2015, limit pensionable compensation for members to not exceed 110% of the average of the four preceding years of pensionable compensation for final average salary calculation purposes.

DISCUSSION

The Retirement Code and System

The State Employees' Retirement Code (Code) is a governmental, cost-sharing, multiple-employer pension plan. The designated purpose of the State Employees' Retirement System (System) is to provide retirement allowances and other benefits, including disability and death benefits to State employees. As of December 31, 2012, there were approximately 105 Commonwealth and other employers participating in SERS.

Membership in SERS is mandatory for most State employees. Certain other employees are not required but are given the option to participate. As of December 31, 2012, there were 106,048 active members and 117,061 annuitant members of SERS.

For most members of the System, 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 SERS are Class AA members and contribute 6.25% of pay to the System. Within SERS, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of State employees.

Act 120 of 2010 implemented major pension reforms, including the establishment of new benefit tiers applicable to most new members. Effective January 1, 2011, most new members (including members of the General Assembly) are required to become members of one of two membership classes, known as "Class A-3" and "Class A-4." Most new members of SERS, other than State Police officers or members employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, become members of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010). Class A-3 members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution requirement of 6.25% of compensation. As an alternative to Class A-3, an employee who becomes a member of SERS on or after January 1, 2011, may elect Class A-4 membership within 45 days of becoming a member of SERS. A Class A-4 member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 9.3% of compensation.

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. For most members of SERS who first became members after the effective date of Act 120, the superannuation requirement is age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 with at least 35 years of credited service, and age 55 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 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 plan proposed in the bill for new or returning State employees, 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 entail 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 as employees approach retirement age.

Defined Contribution Plan for State Employees

The bill would establish a new mandatory governmental retirement plan, known as the State Employees' Defined Contribution Plan ("Plan"), for all new State employees or employees returning after a break in service on or after the year 2015. The defined benefit plan provided by SERS would be closed to new entrants or returning employees effective January 1, 2015.

Current members of SERS would retain membership in the System unless they choose to become a participant in the new DC plan, at which point they would cease accruing service credit in SERS. Membership benefits already accumulated prior to election in the DC plan would be frozen in the System, but available to the employee upon retirement. Election to participate in the plan can be made at any time, and would be an irrevocable election. An employee who is both a member of the System and a participant in the plan would be known as a "combined service employee." After electing to participate in the Plan, the employee would be prohibited from purchasing any previous State or creditable nonstate service. Under Section 5307 of the bill, for an active member who elects to become a participant in the Plan, vesting requirements under the System (five-year vesting for Class AA and ten-year vesting for Classes A-3 & A-4) shall be considered to have been satisfied if the employee participates in the Plan for three or more years. A combined service employee would also be eligible for a superannuation annuity under the System after three years of participation in the Plan.

For the purposes of the Commission's discussion, the major issues of the new pension plan 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 mandates the creation of the State Employees' Defined Contribution Plan, establishes the SERS Board as administrator of the Plan, and sets forth the Board's powers and duties. Most of the details governing the actual operation of the new Plan are delegated to the Board which will be responsible for establishing the rules and regulations governing the Plan. These rules and regulations will presumably address the many specific details involved in the operation of a public pension plan. It also appears that most of the new Plan's investment and administrative functions may be handled by third-party administrators contracted by the Board to provide the necessary services.

Coverage, Benefits and Contributions

Most State employees who participate in the new DC plan would be required to contribute a mandatory 4% of compensation with an employer-matching contribution of 4% of compensation. For hazardous duty employees (including Capitol Police and park rangers), the employer contribution rate would be 5.5% of compensation. For State Police officers, the employer contribution rate would be 12.2% of compensation. Also, special rules for retirement benefits would apply to State Police who have less than 20 years of service as of December 31, 2014, and retire after January 1, 2015, with more than 20 years of service.

A participant may make additional contributions to the pension plan up to the limits imposed by federal law. Participants in the Plan would be 100% vested immediately in all employee and employer contributions, as well as any interest and earnings attributed to those contributions. Contributions on behalf of the participant and the employer would be credited to an "individual investment account" for each participant of the new Plans, along with all interest and investment gains or losses. For investment purposes, the Board may pool the assets of the participants in the Plan.

Investments

While the bill does not specifically mention the type of investments that will be offered to the participants, governmental defined contribution plans typically offer a variety of investment options, including lifestyle funds that are based upon age and projected retirement date. The Plan will most likely also make available investment options that represent a broad cross-section of asset classes and risk profiles. The bill states that the SERS Board will not be held responsible for any investment losses incurred by participants in the Plan or for the failure of any investment to earn a specific or expected return. All fees, costs and expenses of administering the Plan will be assessed against the accounts created on behalf of participants.

Ancillary Issues

Death and Disability Benefits. Beyond payment of the participant's account balance to the designated beneficiary upon the death of an active participant, there are no special death or disability benefit provisions to provide for the surviving spouse or children of a Plan participant.

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. Because a participant in the Plan would not accrue credited service in the System, it is unclear how or if REHP participation would be incorporated into the DC 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. Under the bill, the accumulated contributions of a participant shall not be forfeited but will be made available for payment of any fines or restitution.

Limitations on Compensation and Final Average Salary

Amendment Number 02259 proposes two new limits on compensation that may be used for purposes of calculating the retirement benefits of active members of SERS. The proposed changes are: 1) increasing the period over which the member's final average salary may be calculated from three years to five years; and 2) imposing the "New York Rule" for averaging compensation. The overall impact will be to reduce from current benefit levels the potential future retirement benefits of the affected members.

The System currently employs a member's "final average salary" as one of the components of the statutory formula that is used to compute a member's retirement benefit entitlement. Currently, a member's final average salary is calculated as the average of the highest three years of compensation. The amendment to the bill would amend the Code to change the final average salary calculation from the average of the highest three to the average of the highest five years of compensation for all prospective State service credited on or after January 1, 2015. All service performed and credited prior to the year 2015 would retain the three-year final average salary calculation. A new final average salary calculation at the time of retirement would include two components; both the final average salary using the three-year average for all service performed and credited prior to the year 2015, combined with the final average salary calculated over the highest five years of State service for all service credited after the year 2015.

The amendment to the bill would apply a new limit on the level of compensation that may be used for final average salary determination purposes, known as the "New York Rule." Under this provision, the pensionable compensation cannot exceed 110% of the average of the four preceding years.

Members' Retirement Options

The maximum single-life annuity is the basic retirement benefit entitlement for members of 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 SERS' Retirement Code provides 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. Retirement Option 4 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 Act 120 of 2010, the election to withdraw the member's accumulated deductions under Option 4 was 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 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.

Under the bill, the election to withdraw the member's accumulated deductions under Option 4 would remain available to current members of SERS. However, Amendment Number 02204 would implement a change in the manner in which the Option 4 withdrawal is computed to make Option 4 actuarially cost neutral to the System for all service credited after the year 2015. For all service performed and credited before the year 2015 by current active members of the System, the accumulated deduction calculation will remain unchanged.

Potential Contract Impairment

By altering the benefit provisions for members in SERS on or after January 1, 2015, it appears that the bill and amendments may impair the retirement benefit rights of active members of the System. Historically, 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).[1] *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).

Implications of Closing SERS to New Members

As noted previously, membership in SERS would be closed to all new employees or employees returning after a break in service on or after the year 2015. However, the retirement system will retain its 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 System's 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. The System currently has a large unfunded actuarial accrued liability that will need to be covered by future contributions. The liabilities of 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 SERS is 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

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

cost of paying down these liabilities will result in increased 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 for SERS. Changes due to legislative action are to be amortized over a ten-year period.

Beginning July 1, 2014, changes in the accrued liability of SERS due to the bill as amended will be amortized on a level-dollar basis over a period of 20 years. The bill also requires a "fresh-start" re-amortization of the remaining unfunded accrued liability on a level-dollar basis over a period of 30 years. All other future changes in liability due to legislation subsequent to December 31, 2014, will be amortized over 10 years on a level-dollar basis.

As the active membership declines within the 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.

Once active membership in SERS has significantly declined and retired members are the majority of the System's total membership, the System may also need to consider revising its investment policies. Due to the need to ensure sufficient liquidity to provide for the payment of benefits, 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, the amendments, and the actuarial cost estimate provided to the Commission by Hay Group, the consulting actuary for SERS (see attachments). On Friday, June 21, 2013, the Commission also received certain actuarial work prepared by Milliman, Inc. for the Office of the Budget (all referenced materials, including the work of the Commission's consulting actuary, Cheiron, are attached). The following summarizes the views of the Commission's consulting actuary.

Implications of Closing the System to New Entrants.

The bill closes the defined benefit plan to future members. Any anticipated cost savings under the bill as amended may be offset by the closing of the defined benefit system. The implications of a decreasing contribution stream and an increasing benefit payout stream of a closed plan changes the risks of financing these benefits over time.

While the move from a defined benefit to a defined contribution plan transfers the portion of future benefit financing anticipated to be derived from investment returns, it will take a significant period of time before that risk transfer materially reduces the funding obligations. In the meantime, the higher risks to the closed defined benefit plans may result in higher and more volatile costs.

It can be anticipated that financing benefits for the same participants in a closed plan through contributions will be greater than for the same participants in an open plan because of the decreasing working life of active employees and the ever decreasing period for recovery from market volatility. This will likely lead to the need for more conservative assumptions and result in overall higher costs. Therefore, in a closed plan, it is reasonable to expect lower investment returns on assets needed to meet increasingly shorter term obligations as time goes on. Using a lower investment return to value the plan's obligations will result in a higher liability and higher contributions.

The Commission's consulting actuary concluded that the modifications to the long-term interest rates and amortization periods used in the Hay analysis were reasonable. However, Hay Group did not provide an analysis of how they arrived at the interest rate structure. The Commission's consulting actuary suggests that Hay Group and SERS seek advice from the SERS' investment consultant on the most appropriate interest rate structure, given the System's projected liquidity needs.

Cheiron was provided with copies of work prepared by Milliman, Inc. for the Office of the Budget. In their work product, Milliman acknowledges that in the future the investment rate of return assumption will need to be lowered due to increased liquidity requirements resulting from closure of the defined benefit plan. However, Milliman asserts that the investment rate of return does not need to be lowered during the projection period because the liquidity requirements of the System will not materially change during that period. Milliman bases their liquidity analysis on a "liquidity ratio" defined as the expected benefit payments in the upcoming year divided by the market value of assets. The Commission's consulting actuary does not consider this method to be an appropriate measure of liquidity since not all of the System's assets are liquid. Milliman should consider comparing the contributions coming into the System to the benefit payments and whether there is a negative cash flow.

Desirability of Further Analysis.

The Commission's consulting actuary has concluded that the cost estimate prepared by Hay Group reflects a single alternative analysis of the implications of future investment returns and amortization periods. The Commission's consulting actuary has indicated that a more robust analysis using multiple scenarios or a stochastic analysis that measures the sensitivity of the System, the magnitude of the potential future cost and future implications would be more valuable to policymakers in understanding the implication of the additional risk the bill presents to the long-term solvency of the System, relative to the sustainable level of potential costs.

Governmental Accounting Board Statements Number 67 and 68.

Finally, many of these issues may also become significant regardless of the System's or the Commonwealth's funding policies because of the new reporting obligations under Governmental Accounting Standards Board (GASB) statement number 67 and 68, which will require more rapid recognition of changes in the net unfunded liability and the reporting of these amounts on the Commonwealth's balance sheet. So while the current methods may act to defer the funding obligations, the new accounting standards will require full recognition of the unfunded liabilities in the Commonwealth's financial statements.

POLICY CONSIDERATIONS

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

<u>Potential Contract Impairment</u>. Historically, 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). As written, the active member benefit modifications proposed in the amendments may be found to impair the benefit rights of the affected active members.

<u>Benefit Value and Security</u>. While a detailed benefit comparison was beyond the scope of this actuarial note, the DC plan proposed in the bill would provide new state employees and employees returning after a break in service with a retirement income that is likely to be less valuable, predictable and secure than that provided by the traditional DB pension plan. 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.

<u>Delegation of Legislative Authority</u>. The bill empowers the Board of the System to develop the details of major DC plan design elements and administrative details by rule or regulation. The General Assembly and the Governor must determine if the broad powers afforded the Board constitutes an appropriate delegation of legislative authority.

<u>Technical Operational Issues</u>. In reviewing the bill and amendments, the Commission staff noted the following technical operational issues.

Closed Group Funding Dynamics. The bill would close SERS to new entrants effective 2015, substituting membership in the System with participation in a DC plan for new employees and employees returning after a break in service.

In its work product, the consulting actuary for SERS describes the major issues associated with the funding dynamics of a defined benefit retirement system that has been closed to new entrants. Amortization periods that exceed the average remaining service of active members, and the manner in which investment return assumptions are set by the retirement system boards will all require review and adjustment if the bill becomes law. Generally, shorter amortization periods combined with reductions in investment return assumptions in order to ensure liquidity to pay benefits when due would have the effect of increasing employer contribution requirements.

Risk Sharing. Under the defined benefit structure of SERS, all of the longevity risk (the risk of members outliving their retirement income) and most of the investment risk is borne by the retirement system. Under current law, only those members subject to Act 120 of 2010 (Classes A-3 and A-4) share in the investment risk of the System through the shared-risk contribution requirement imposed by Act 120. All pre-Act 120 members of the System are exempt from the shared-risk contribution requirement. Under the bill, all new employees would be enrolled in a DC plan and would be required to bear all of the investment risk and longevity risk associated with managing their retirement accounts. This situation creates significant risk-sharing disparities among various cohorts of employees.

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. Because a participant in the Plan would not accrue credited service in the System, it is unclear how or if REHP participation would be incorporated into the DC plan.

COMMISSION RECOMMENDATION

On June 25, 2013, the Commission voted to attach the actuarial notes to the bill and amendments, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

A later version of House Bill Number 1353 had first consideration on June 25, 2013, and was re-referred to the House Rules Committee.

To view this note in its entirety, click the following link: House Bill Number 1353, Printer's Number 1847, as amended by Amendment Numbers 02204 and 02259

Bill ID: Amendment Numbers 02634, 02717 and 02750 to
House Bill Number 1353, Printer's Number 2152

System: State Employees' Retirement System

Subject: Defined Contribution Retirement Plan

SYNOPSIS

House Bill Number 1353, Printer's Number 2152, would amend Title 71 (State Employees' Retirement Code) to:

1) Add a new chapter, Chapter 54, titled "State Employees' Defined Contribution Plan." Chapter 54 would establish a mandatory defined contribution plan for State employees whose most recent period of State service starts on or after January 1, 2015. Employer contributions to the plan would be equal to 4% of salary for most employees, with a mandatory employee contribution of 4% of salary;

2) Permit current State Employees' Retirement System (SERS) members to elect to participate in the defined contribution plan prospectively, with a 4% employer contribution and 4% contribution for all subsequent State service;

3) For current members of SERS who elect the Option 4 lump-sum withdrawal upon retirement after January 1, 2015, modify the manner of determining the net annuity to make the option actuarially cost neutral to the System for all employee contributions made after the year 2015;

4) Modify the calculation of "final average salary" applicable to current SERS members from the average of the highest three years of service to the average of the highest five years for all service performed or first credited on or after January 1, 2015; and

5) For service performed or credited to current SERS members on or after January 1, 2015, limit pensionable compensation for members to not exceed 110% of the average of the four preceding years of pensionable compensation for final average salary calculation purposes.

Amendment Numbers 02634 and 02717, which are substantively identical, would amend the bill to:

1) Exempt from mandatory participation in the defined contribution plan a sworn officer of the Pennsylvania State Police, an enforcement officer, or a correction officer.

2) Expand the definition of "enforcement officer," as defined in the SERS Code, to include the following:

   Wildlife conservation officers and other commissioned law enforcement personnel employed by the Pennsylvania Game Commission;

   Any Delaware River Port Authority Policeman, park ranger or Capitol Police officer;

   Any campus police officer employed by a State-owned educational institution, community college or the Pennsylvania State University;

Any police officer employed by Fort Indiantown Gap or other designated Commonwealth military installations and facilities.

Amendment Number 02750 would amend the bill to:

1) Exempt from mandatory participation in the defined contribution plan a sworn officer of the Pennsylvania State Police or a correction officer.

DISCUSSION

The Retirement Code and System

The State Employees' Retirement Code (Code) is a governmental, cost-sharing, multiple-employer pension plan. The designated purpose of the State Employees' Retirement System (System) is to provide retirement allowances and other benefits, including disability and death benefits to State employees. As of December 31, 2012, there were approximately 105 Commonwealth and other employers participating in SERS.

Membership in SERS is mandatory for most State employees. Certain other employees are not required but are given the option to participate. As of December 31, 2012, there were 106,048 active members and 117,061 annuitant members of SERS.

For most members of the System, 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 SERS are Class AA members and contribute 6.25% of pay to the System. Within SERS, there are a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of State employees.

Act 120 of 2010 implemented major pension reforms, including the establishment of new benefit tiers applicable to most new members. Effective January 1, 2011, most new members (including members of the General Assembly) are required to become members of one of two membership classes, known as "Class A-3" and "Class A-4." Most new members of SERS, other than State Police officers or members employed in a position for which a class of service other than Class A or Class AA is credited or could be elected, become members of Class A-3 beginning January 1, 2011 (or if a member of the General Assembly, beginning December 1, 2010). Class A-3 members are eligible for an annuity based upon an annual benefit accrual rate of 2% and have a corresponding employee contribution requirement of 6.25% of compensation. As an alternative to Class A-3, an employee who becomes a member of SERS on or after January 1, 2011, may elect Class A-4 membership within 45 days of becoming a member of SERS. A Class A-4 member is eligible for an annuity based upon an annual benefit accrual rate of 2.5% with a corresponding employee contribution requirement equal to 9.3% of compensation.

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. For most members of SERS who first became members after the effective date of Act 120, the superannuation requirement is age 65 with a minimum of three years of service credit, or any combination of age and service that totals 92 with at least 35 years of credited service, and age 55 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 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 plan proposed in the bill for new or returning State employees, 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 entail 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 as employees approach retirement age.

HOUSE BILL NUMBER 1353, PRINTER'S NUMBER 2152

Defined Contribution Plan for State Employees

The bill would establish a new mandatory governmental retirement plan, known as the State Employees' Defined Contribution Plan ("Plan"), for all new State employees or employees returning after a break in service on or after the year 2015. The defined benefit plan provided by SERS would be closed to new entrants or returning employees effective January 1, 2015.

Current members of SERS would retain membership in the System unless they choose to become a participant in the new DC plan, at which point they would cease accruing service credit in SERS. Membership benefits already accumulated prior to election in the DC plan would be frozen in the System, but available to the employee upon retirement. Election to participate in the plan can be made at any time, and would be an irrevocable election. An employee who is both a member of the System and a participant in the Plan would be known as a "combined service employee." After electing to participate in the Plan, the employee would be prohibited from purchasing any previous State or creditable nonstate service. Under Section 5307 of the bill, for an active member who elects to become a participant in the Plan, vesting requirements under the System (five-year vesting for Class AA and ten-year vesting for Classes A-3 & A-4) shall be considered to have been satisfied if the employee participates in the Plan for three or more years. A combined service employee would also be eligible for a superannuation annuity under the System after three years of participation in the Plan.

For the purposes of the Commission's discussion, the major issues of the new pension plan 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 mandates the creation of the State Employees' Defined Contribution Plan, establishes the SERS Board as administrator of the Plan, and sets forth the Board's powers and duties. Most of the details governing the actual operation of the new Plan are delegated to the Board which will be responsible for establishing the rules and regulations governing the Plan. These rules and regulations will presumably address the many specific details involved in the operation of a public pension plan. It also appears that most of the new Plan's investment and administrative functions may be handled by third-party administrators contracted by the Board to provide the necessary services.

Coverage, Benefits and Contributions

Most State employees who participate in the new DC plan would be required to contribute a mandatory 4% of compensation with an employer-matching contribution of 4% of compensation. For hazardous duty employees (including Capitol Police and park rangers), the employer contribution rate would be 5.5% of compensation. For State Police officers, the employer contribution rate would be 12.2% of compensation. Also, special rules for retirement benefits would apply to State Police who have less than 20 years of service as of December 31, 2014, and retire after January 1, 2015, with more than 20 years of service.

A participant may make additional contributions to the pension plan up to the limits imposed by federal law. Participants in the Plan would be 100% vested immediately in all employee and employer contributions, as well as any interest and earnings attributed to those contributions. Contributions on behalf of the participant and the employer would be credited to an "individual investment account" for each participant of the new Plan, along with all interest and investment gains or losses. For investment purposes, the Board may pool the assets of the participants in the Plan.

Investments

While the bill does not specifically mention the type of investments that will be offered to the participants, governmental defined contribution plans typically offer a variety of investment options, including lifestyle funds that are based upon age and projected retirement date. The Plan will most likely also make available investment options that represent a broad cross-section of asset classes and risk profiles. The bill states that the SERS Board will not be held responsible for any investment losses incurred by participants in the Plan or for the failure of any investment to earn a specific or expected return. All fees, costs and expenses of administering the Plan will be assessed against the accounts created on behalf of participants.

Ancillary Issues

Death and Disability Benefits. Beyond payment of the participant's account balance to the designated beneficiary upon the death of an active participant, there are no special death or disability benefit provisions to provide for the surviving spouse or children of a Plan participant.

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. Because a participant in the Plan would not accrue credited service in the System, it is unclear how, or if, REHP participation would be incorporated into the DC 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. Under the bill, the accumulated contributions of a participant shall not be forfeited, but will be made available for payment of any fines or restitution.

Limitations on Compensation and Final Average Salary

The bill proposes two new limits on compensation that may be used for purposes of calculating the retirement benefits of active members of SERS. The proposed changes are: 1) increasing the period over which the member's final average salary may be calculated from three years to five years; and 2) imposing the "New York Rule" for averaging compensation. The overall impact will be to reduce from current benefit levels the potential future retirement benefits of the affected members.

The System currently employs a member's "final average salary" as one of the components of the statutory formula that is used to compute a member's retirement benefit entitlement. Currently, a member's final average salary is calculated as the average of the highest three years of compensation. The bill would amend the Code to change the final average salary calculation from the average of the highest three to the average of the highest five years of compensation for all prospective State service credited on or after January 1, 2015. All service performed and credited prior to the year 2015 would retain the three-year final average salary calculation. A new final average salary calculation at the time of retirement would include two components; both the final average salary using the three-year average for all service performed and credited prior to the year 2015, combined with the final average salary calculated over the highest five years of State service for all service credited after the year 2015.

The bill would also apply a new limit on the level of compensation that may be used for final average salary determination purposes, known as the "New York Rule." Under this provision, the pensionable compensation cannot exceed 110% of the average of the four preceding years.

Members' Retirement Options

The maximum single-life annuity is the basic retirement benefit entitlement for members of 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 SERS' Retirement Code provides 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. Retirement Option 4 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 Act 120 of 2010, the election to withdraw the member's accumulated deductions under Option 4 was 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 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.

Under the bill, the election to withdraw the member's accumulated deductions under Option 4 would remain available to current members of SERS. However, the manner in which the Option 4 withdrawal is computed would be changed to make Option 4 actuarially cost neutral to the System for all service credited after the year 2015. For all service performed and credited before the year 2015 by current active members of the System, the accumulated deduction calculation will remain unchanged.

Special Membership Classes

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, there would be no special benefit provisions for some of these groups of employees in the new State Employees' DC plan.

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 is likely to be challenged in the courts.

There is also case law concerning altering the benefit provisions for members of the General Assembly or other State office-holders after being re-elected to office. In *Shiomos v. State Employees' Retirement Board,* 533 Pa. 558, 626 A. 2d 158 (1993), the Supreme Court held that a public official, at every new term of employment, renews his pension contract to include his new public service and to place at risk that which was already earned. A public official's re-election to office renews the official's employment contract subject to the law as it stands at the time the new term of office commences.[1]

Potential Contract Impairment

By altering the benefit provisions for members in SERS on or after January 1, 2015, it appears that the bill may impair the retirement benefit rights of active members of the System. Historically, 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).

AMENDMENT NOS. 02634, 02717 AND 02750 TO HOUSE BILL NUMBER 1353, PRINTER'S NUMBER 2152

The amendments to House Bill Number 1353, Printer's Number 2152, would amend the bill to exempt certain employee groups from mandatory participation in the new DC plan. The details of each amendment to the bill are described.

[1]Berkhimer v. State Employees' Retirement Board, 2031 C.D. 2011

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

Amendment Numbers 02634 and 02717

Amendment Numbers 02634 and 02717 to the bill are substantively identical and would exempt members of the Pennsylvania State Police, enforcement officers, and correction officers from mandatory participation in the new DC plan. All prospective employees of these groups would continue to be eligible for membership in SERS after 2015. The amendment would also expand the definition of "enforcement officer," as defined in the SERS Code, to include the following groups of employees: wildlife conservation officers and other commissioned law enforcement personnel employed by the Game Commission; Delaware River Port Authority Policeman, park rangers or Capitol Police officers; campus police officers employed by any State-owned educational institutions, community college or Penn State University; and police officers employed by Fort Indiantown Gap or other designated Commonwealth military installations and facilities.

The key difference in the language of the two amendments is the manner in which the applicable members are exempted from the new DC plan. Amendment Number 02717 excludes members of the State Police, enforcement officers and correction officers from participation in the DC plan by removing them from both the definitions of "active participant" and "employer defined contributions." Amendment Number 02634 only excludes the employee groups from the definition of "active participant," while the employees remain listed under the definition of "employer defined contributions." This is contradictory language that the Commission believes to be a drafting oversight.

Amendment Number 02750

Amendment Number 02750 to the bill would only exempt members of the Pennsylvania State Police and correction officers from joining the new DC plan. All prospective employees of these two groups would continue to be eligible for membership in SERS after 2015.

Pennsylvania State Police, Correction Officers and Enforcement Officers

Special retirement coverage for various public safety employees often is provided in public employee retirement systems. The enhanced benefits are premised on the hazardous nature of public safety employment and the physical and psychological demands of public safety work. Under the State Employees' Retirement Code, the special retirement benefit for most Commonwealth public safety employees, including correction and enforcement officers, is the eligibility to retire at age 50 with full retirement benefits. For public safety employees who first became members of SERS after the effective date of Act 120, retirement age is age 55.
Because the death benefit for any Commonwealth employee is dependent on the retirement age, the special public safety employees' retirement coverage also increases the death benefit.

The benefits of State Police officers are affected by the DiLauro arbitration award. The award provided that officers with 20 years of service are eligible to receive a retirement benefit of 50% of the officer's highest full year's salary, and those with 25 years of service shall receive 75% of the highest full year's salary. Years of service between 20 and 25 or after 25 do not produce incremental benefit increases. The award applies to officers who retire on or after July 1, 1989. (Class A members with less than 20 years of service are not affected by the award and are eligible for the statutory Class A benefit at a 2.0% benefit accrual rate. No State Police officer is entitled to the Act 9 benefit accrual rate of 2.5% because members of the State Police were specifically excluded from coverage by that statute). By the act of August 5, 1991 [P. L. 183, No. 23], 71 Pa. C. S. § 5955 was amended to provide that SERS retirement benefits are exclusively statutory and cannot be changed by collective bargaining agreements or arbitration awards under such agreements. That section grandfathered pre-existing awards, including DiLauro, but the amendment does not foreclose the legislature from prospectively altering benefits for new State Police officers by statute.

The term "enforcement officer" is a defined term in the SERS Code designating certain categories of public safety employees. These categories of employees are entitled to special benefit coverage. Under the Code, the employees currently eligible for the special benefit coverage as public safety employees include the following: Liquor Control Board enforcement officers and investigators; Office of Attorney General special agents, narcotics agents, asset forfeiture agents, Medicaid fraud agents, and senior investigators of the hazardous prosecutions unit; Pennsylvania Board of Probation and Parole parole agents; Department of Corrections correction officers; Department of Public Welfare psychiatric security aides; Delaware River Port Authority police officers; Department of General Services capitol police officers; Department of Conservation and Natural Resources park rangers; waterways conservation officers of the Pennsylvania Fish and Boat Commission; and Pennsylvania State Police officers.

Amendment Numbers 02634 and 02717 would amend the bill by expanding the definition of "enforcement officers," as defined in the Code, to include several groups of employees who have never before received enhanced benefits, including: wildlife conservation officers, campus police officers and police officers at military installations and facilities. Under Amendment Number 02717, however, one employee group that is currently categorized as "enforcement officers" under the SERS Code, psychiatric security aides, would still be required to become mandatory participants in the new DC plan. The rationale for this group's inclusion in the DC plan while exempting all other public safety employees is unclear. Other employee groups, such as Delaware River Port Authority policemen, Capitol Police officers and park rangers already receive age 50 superannuation, or age 55 in the case of Act 120 members, so the rationale for adding them to the definition of "enforcement officer" in the amendments is unclear. These employee groups that would traditionally have received normal retirement benefits at age 60, or age 65 in the case of Act 120 members, would instead be eligible for an early superannuation age with full retirement benefits. This broadening of the definition of enforcement officers would apply to both current and future members of the System and would produce new, ongoing and unfunded liability costs to the System.

IMPLICATIONS OF CLOSING SERS TO NEW MEMBERS

As noted previously, membership in SERS would be closed to all new employees or employees returning after a break in service on or after the year 2015. However, the retirement system will retain its 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 System's statutory funding provisions.

Under the amendments to the bill, SERS would be closed to most new members but would maintain a vestigial DB plan containing only State Police officers, enforcement officers and correction officers in the case of Amendment Nos. 02634 and 02717, and only State Police officers and correction officers in the case of Amendment No. 02750, with new employees of these groups continuing to be eligible for membership in SERS after 2015.

To give a better understanding of the number of current members that would remain in a vestigial DB plan, SERS has provided the Commission staff with information on the number of members for each employee group that would be affected by the proposed amendments. This information, along with the estimated total membership that would remain in a vestigial DB plan is shown in the following two tables.

TABLE 1
EMPLOYEE GROUPS AFFECTED UNDER AMENDMENT NOS. 02634 AND 02717 TO HOUSE BILL NO. 1353, P. N. 2152

State Employees' Retirement System Employee Group	Number of Members
Sworn Members of the Pennsylvania State Police	4,184
Enforcement Officers	1,100 (est.)
Correction Officers	11,590
Wildlife Conservation Officers	77
Other Commissioned Law Enforcement Personnel of the Game Commission	192
Delaware River Port Authority Policemen	142
Park Rangers	181
Capitol Police Officers	88
Campus Police Officers Employed by a State-owned Educational Institution	135
Campus Police Officers Employed by a Community College	20 (est.)
Campus Police Officers Employed by Penn State University	89
Police Officers Employed by Fort Indiantown Gap	16
Police Officers Employed by Other Designated Military Installations and Facilities	Unknown
Total Estimated Membership	17,814

Note: Amendment Number 02717 does not exempt psychiatric security aides from mandatory participation in the new DC plan, although they are categorized as "enforcement officers" under the SERS Code. (The number of members is unknown.)

TABLE 2
EMPLOYEE GROUPS AFFECTED UNDER AMENDMENT NO. 02750 TO HOUSE BILL NO. 1353, P. N. 2152

State Employees' Retirement System Employee Group	Number of Members
Sworn Members of the Pennsylvania State Police	4,184
Correction Officers	11,590
Total Estimated Membership	15,774

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. The System currently has a large unfunded actuarial accrued liability that will need to be covered by future contributions. The liabilities of 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 SERS is 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 increased 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 for SERS. Changes due to legislative action are to be amortized over a ten-year period.

Beginning July 1, 2014, changes in the accrued liability of SERS due to the bill as amended will be amortized on a level-dollar basis over a period of 20 years. The bill also requires a "fresh-start" re-amortization of the remaining unfunded accrued liability on a level-dollar basis over a period of 30 years. All other future changes in liability due to legislation subsequent to December 31, 2014, will be amortized over 10 years on a level-dollar basis.

As the active membership declines within the 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.

Once active membership in SERS has significantly declined and retired members are the majority of the System's total membership, the System may also need to consider revising its investment policies. Due to the need to ensure sufficient liquidity to provide for the payment of benefits, 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.

The Commission's consulting actuary has reviewed the bill and the amendments and prepared an actuarial cost note. In developing the estimates, the Commission's consulting actuary utilized projected future benefit streams, payroll projections and other relevant demographic data supplied to the Commission by the consulting actuary for SERS. The Commission's consulting actuary developed the cost estimates independently utilizing the firm's own models. The estimates are based upon actuarial assumptions contained in the December 31, 2012, actuarial valuation for SERS, including the System's current 7.5% long-term annual investment return assumption and other economic and demographic assumptions.

The overall impact of the bill is to increase employer costs in the short term, but to decrease those costs in the long term, as the current active membership declines and an ever larger percentage of the membership is enrolled in the lower-cost defined contribution pension plan. However, it should be noted that much of the projected savings attributable to the bill are the result of the proposed active member benefit reductions (specifically, the elimination of the Option 4 return of member contribution subsidy and the change to the five-year final average salary calculation), the 30-year fresh start amortization of unfunded liabilities, and an employer defined contribution rate of 4% compared with the current defined benefit plan's employer normal cost rate of 5.01%. The analysis also shows a slight savings resulting from the amendments to the bill, which would preserve a vestigial defined benefit plan for certain public safety employees (representing approximately 14% – 17% of the current active membership of SERS).

The actuarial cost impact is shown in the following tables.

Table 3 shows projections of the plan's funded ratio under the current plan, the bill and the amendments. The funded ratio is equal to the actuarial assets divided by the liability. Over time, the liabilities of the defined benefit (DB) plan will decline as new members are covered under the new defined contribution (DC) plan. However, fewer members in the DB plan also equates to a reduction in funding of the DB plan (employer normal contributions and member contributions will decrease as the DB payroll decreases). Therefore, over time, the funded ratio will be lower under House Bill Number 1353 compared with the current plan. This also explains why the funded ratio is higher under Amendment Numbers 02634/02717 and 02750 when compared with House Bill Number 1353.

Table 3
State Employees' Retirement System
Projection of Funded Ratio

Fiscal Year	Current Plan	H. B. 1353	Amend. 02634/02717	Amend. 02750
2014	58.8%	58.8%	58.8%	58.8%
2015	58.7%	60.0%	60.0%	60.0%
2016	58.7%	60.1%	60.1%	60.1%
2017	59.0%	60.5%	60.5%	60.5%
2018	60.7%	62.0%	62.0%	62.0%
2019	62.3%	63.1%	63.1%	63.1%
2020	63.8%	64.1%	64.2%	64.2%
2021	65.3%	65.1%	65.2%	65.2%
2022	66.8%	66.1%	66.2%	66.2%
2023	68.4%	67.1%	67.2%	67.2%
2024	69.9%	68.0%	68.2%	68.2%
2025	71.5%	68.9%	69.2%	69.1%
2026	73.1%	69.8%	70.1%	70.1%
2027	74.8%	70.7%	71.1%	71.1%
2028	76.5%	71.6%	72.1%	72.0%
2029	78.2%	72.5%	73.1%	73.1%
2030	80.0%	73.5%	74.1%	74.1%
2031	81.8%	74.5%	75.2%	75.2%
2032	83.7%	75.5%	76.4%	76.3%
2033	85.7%	76.6%	77.6%	77.6%
2034	87.7%	77.8%	78.9%	78.9%

Table 4 shows the projected changes in unfunded actuarial liability (UAL) between the current plan, House Bill Number 1353, Amendment Numbers 02634/02717 and Amendment Number 02750. The UAL is lower under House Bill Number 1353 compared to the current plan due to the active member benefit reductions proposed under House Bill Number 1353, which lower the liability of the plan. The UAL under Amendment Numbers 02634/02717 and Amendment Number 02750 is higher than the UAL under House Bill Number 1353 since the difference between the actual normal contribution for State police, correction officers and enforcement officers and the normal rate of 5.01% of payroll for post-Act 120 members becomes a component of UAL. The UAL is just slightly higher under Amendment Numbers 02634/02717 than Amendment Number 02750 since enforcement officers are included in the DB plan under Amendment Numbers 02634/02717, but are excluded under Amendment Number 02750.

Table 4
State Employees' Retirement System
Projection of Unfunded Liability
(In Billions)

Fiscal Year	Current Plan	H. B. 1353	Amend. 02634/02717	Amend. 02750
2014	$17.753	$17.753	$17.753	$17.753
2015	$18.219	$17.238	$17.235	$17.235
2016	$18.646	$17.577	$17.576	$17.576
2017	$18.919	$17.740	$17.743	$17.743
2018	$18.495	$17.353	$17.357	$17.356
2019	$18.126	$17.109	$17.112	$17.112
2020	$17.731	$16.848	$16.851	$16.851
2021	$17.305	$16.566	$16.569	$16.569
2022	$16.846	$16.262	$16.265	$16.265
2023	$16.355	$15.938	$15.941	$15.940
2024	$15.827	$15.589	$15.592	$15.592
2025	$15.260	$15.215	$15.218	$15.218
2026	$14.651	$14.812	$14.815	$14.815
2027	$13.995	$14.380	$14.383	$14.382
2028	$13.291	$13.915	$13.918	$13.917
2029	$12.534	$13.415	$13.418	$13.417
2030	$11.720	$12.878	$12.880	$12.880
2031	$10.845	$12.300	$12.302	$12.302
2032	$9.904	$11.679	$11.681	$11.681
2033	$8.893	$11.011	$11.014	$11.013
2034	$7.806	$10.294	$10.296	$10.296

Tables 5 and 6 show the impact upon employer contribution requirements. The tables show that the total employer contribution (DB + DC) is lower under House Bill Number 1353 than the current plan. This is due to the active member benefit reductions in the DB plan and the fresh start amortization of the UAL over 30 years. It also is due to a lower employer contribution rate for the DC plan compared to the employer normal cost rate for the DB plan.

Employer contributions under Amendment Numbers 02634/02717 and Amendment Number 02750 are lower than that of House Bill Number 1353. The total employer contributions under the two amendments are very similar, with total employer contributions under Amendment Number 02750 just slightly higher than Amendment Numbers 02634/02717. Though seemingly counterintuitive, the difference results from the differences between the employer normal contribution rate in the DB plan compared to the DC plan for State police, correction officers and enforcement officers and the methodology used to develop the DB employer contribution rates.

The DC employer contribution rate under House Bill Number 1353 is 12.2% for State Police officers and 5.5% for correction officers and enforcement officers. Under the DB plan, the employer normal contribution rate is 5.01% for <u>all</u> employees. The funding methodology used by SERS for the DB plan is a variation of the entry age normal cost method. Under the traditional entry age normal cost method, a contribution rate is determined for all employees such that if that rate is applied to the member's salary, from date of entry into the plan until the member retires, it will be sufficient to fund the member's lifetime retirement benefit. The method used by SERS (which is set in statute) bases the normal contribution rate only on the benefits and contributions for new employees, rather than for all current members. Since new Act 120 members are entitled to benefits of a lesser value than members hired prior to the effective date of Act 120, the employer normal contribution is artificially low. The difference between the actual normal contribution rate and the rate determined under the SERS methodology becomes a component of the UAL, which is then funded over 30 years. The 30-year amortization period is a longer period than what is considered the average future working lifetime of the member. In other words, the methodology used by SERS funds the cost of the plan over a longer period of time resulting in an artificially low employer contribution rate.

Table 5
State Employees' Retirement System
Projection of Employer Contributions (DB and DC)

Fiscal Year	Current Plan	H. B. 1353	Amend. 02634/02717	Amend. 02750
2014	16.0%	16.0%	16.0%	16.0%
2015	20.5%	20.7%	20.7%	20.7%
2016	25.0%	25.4%	25.3%	25.3%
2017	29.5%	27.7%	27.6%	27.6%
2018	29.7%	26.7%	26.6%	26.6%
2019	28.8%	25.9%	25.8%	25.8%
2020	28.0%	25.2%	25.0%	25.1%
2021	27.2%	24.5%	24.3%	24.3%
2022	26.5%	23.9%	23.6%	23.6%
2023	25.8%	23.2%	23.0%	23.0%
2024	25.1%	22.6%	22.3%	22.3%
2025	24.4%	22.0%	21.7%	21.7%
2026	23.7%	21.4%	21.1%	21.1%
2027	23.1%	20.8%	20.5%	20.5%
2028	22.5%	20.3%	19.9%	19.9%
2029	21.9%	19.8%	19.4%	19.4%
2030	21.3%	19.3%	18.9%	18.9%
2031	20.8%	18.8%	18.4%	18.4%
2032	20.2%	18.3%	17.9%	17.9%
2033	19.7%	17.8%	17.4%	17.4%
2034	19.2%	17.3%	16.9%	17.0%

Table 6
State Employees' Retirement System
Projection of Employer Contributions (DB and DC)
(In Billions)

Fiscal Year	Current Plan	H. B. 1353		Amend. 02634/02717		Amend. 02750	
	Amount	Amount	Increase/ Decrease	Amount	Increase/ Decrease	Amount	Increase/ Decrease
2014	$0.957	$0.959	$0.002	$0.959	$0.002	$0.959	$0.002
2015	$1.269	$1.282	$0.013	$1.279	$0.010	$1.279	$0.010
2016	$1.602	$1.629	$0.028	$1.621	$0.020	$1.622	$0.020
2017	$1.956	$1.834	($0.123)	$1.828	($0.129)	$1.828	($0.128)
2018	$2.036	$1.831	($0.205)	$1.823	($0.213)	$1.823	($0.213)
2019	$2.048	$1.842	($0.206)	$1.832	($0.216)	$1.832	($0.216)
2020	$2.060	$1.854	($0.206)	$1.842	($0.219)	$1.842	($0.219)
2021	$2.073	$1.866	($0.207)	$1.851	($0.222)	$1.852	($0.222)
2022	$2.086	$1.879	($0.207)	$1.861	($0.225)	$1.862	($0.225)
2023	$2.100	$1.892	($0.208)	$1.872	($0.229)	$1.872	($0.228)
2024	$2.114	$1.906	($0.208)	$1.882	($0.232)	$1.883	($0.231)
2025	$2.129	$1.920	($0.209)	$1.894	($0.235)	$1.895	($0.235)
2026	$2.144	$1.935	($0.209)	$1.905	($0.239)	$1.906	($0.238)
2027	$2.160	$1.950	($0.210)	$1.917	($0.243)	$1.919	($0.242)
2028	$2.177	$1.966	($0.211)	$1.930	($0.247)	$1.931	($0.245)
2029	$2.194	$1.982	($0.212)	$1.943	($0.251)	$1.944	($0.249)
2030	$2.211	$1.998	($0.213)	$1.957	($0.255)	$1.958	($0.253)
2031	$2.229	$2.015	($0.214)	$1.971	($0.259)	$1.972	($0.257)
2032	$2.248	$2.032	($0.216)	$1.985	($0.263)	$1.987	($0.261)
2033	$2.268	$2.048	($0.219)	$2.000	($0.267)	$2.002	($0.266)
2034	$2.288	$2.064	($0.224)	$2.016	($0.272)	$2.018	($0.270)

Implications of Closing the System to New Entrants.

The bill closes the defined benefit plan to future members. Any anticipated cost savings under the bill may be offset by the closing or contraction of the defined benefit system. The implications of a decreasing contribution stream and an increasing benefit payout stream of a closed plan changes the risks of financing these benefits over time.

While the move from a defined benefit to a defined contribution plan transfers the portion of future benefit financing anticipated to be derived from investment returns, it will take a significant period of time before that risk transfer materially reduces the funding obligations. In the meantime, the higher risks to the closed defined benefit plans may result in higher and more volatile costs.

It can be anticipated that financing benefits for the same participants in a closed plan through contributions will be greater than for the same participants in an open plan because of the decreasing working life of active employees and the ever decreasing period for recovery from market volatility. This will likely lead to the need for more conservative assumptions and result in overall higher costs. Therefore, in a closed plan, it is reasonable to expect lower investment returns on assets needed to meet increasingly shorter term obligations as time goes on. Using a lower investment return to value the plan's obligations will result in a higher liability and higher contributions.

Governmental Accounting Board Statements Number 67 and 68.

Finally, many of these issues may also become significant regardless of the System's or the Commonwealth's funding policies because of the new reporting obligations under Governmental Accounting Standards Board (GASB) statement number 67 and 68, which will require more rapid recognition of changes in the net unfunded liability and the reporting of these amounts on the Commonwealth's balance sheet. So while the current methods may act to defer the funding obligations, the new accounting standards will require full recognition of the unfunded liabilities in the Commonwealth's financial statements.

POLICY CONSIDERATIONS

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

Potential Contract Impairment. Historically, 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). As written, the active member benefit modifications proposed in the bill may be found to impair the benefit rights of the affected active members.

Benefit Value and Security. While a detailed benefit comparison was beyond the scope of this actuarial note, the DC plan proposed in the bill would provide new State employees and employees returning after a break in service with a retirement income that is likely to be less valuable, predictable and secure than that provided by the traditional DB pension plan. 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.

Delegation of Legislative Authority. The bill empowers the Board of the System to develop the details of major DC plan design elements and administrative details by rule or regulation. The General Assembly and the Governor must determine if the broad powers afforded the 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 there are no special benefit provisions for members of the General Assembly or judiciary. The uniform benefit level under the bill 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 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 is likely to be challenged in the courts.

Renewal of Pension Contract. In *Shiomos v. State Employes' Retirement Board,* 533 Pa. 588, 626 A.2d 158 (1993), the Supreme Court held that a public official, at every new term of office, renews his pension contract subject to the law in effect when the new term of office commences. While this case, and the subsequent decisions that follow its holding, specifically relates to Section 3 of the Public Employee Pension forfeiture Act, 1978, July 8, P. L. 752, No. 140, 43 P.S. § 1313(c), the core of the court's analysis is that a statutory provision can alter otherwise protected benefits contingent upon a change in the nature of the employment. That analysis may apply equally to the statutory amendment proffered by this legislation.

Technical Operational Issues. In reviewing the bill, the Commission staff noted the following technical operational issues.

> *Closed Group Funding Dynamics.* The bill would close SERS to new entrants effective 2015, substituting membership in the System with participation in a DC plan for new employees and employees returning after a break in service. In its work product, the Commission's consulting actuary describes the major issues associated with the funding dynamics of a defined benefit retirement system that has been closed to new entrants. Amortization periods that exceed the average remaining service of active members, and the manner in which investment return assumptions are set by the retirement system boards will all require review and adjustment if the bill becomes law. Generally, shorter amortization periods combined with reductions in investment return assumptions in order to ensure liquidity to pay benefits when due would have the effect of increasing employer contribution requirements.
>
> *Risk Sharing.* Under the defined benefit structure of SERS, all of the longevity risk (the risk of members outliving their retirement income) and most of the investment risk is borne by the retirement system. Under current law, only those members subject to Act 120 of 2010 (Classes A-3 and A-4) share in the investment risk of the System through the shared-risk contribution requirement imposed by Act 120. All pre-Act 120 members of the System are exempt from the

shared-risk contribution requirement. Under the bill, all new employees would be enrolled in a DC plan and would be required to bear all of the investment risk and longevity risk associated with managing their retirement accounts. This situation creates significant risk-sharing disparities among various cohorts of employees.

Nondiscrimination Provision. As the existing defined benefit plan gradually loses active members, the risk of violating the nondiscrimination provisions and participation requirements of the Internal Revenue Code, Sections 401(a)(4) and (26), and 414, is likely to develop. These issues should be reviewed by qualified tax counsel.

*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. Because a participant in the Plan would not accrue credited service in the System, it is unclear how, or if, REHP participation would be incorporated into the DC plan.

In reviewing Amendment Numbers 02634 and 02717, the Commission identified the following policy considerations:

<u>Expanded Definition of Enforcement Officer</u>. The amendments would amend the bill to expand the definition of "enforcement officers," as defined in the Code, to include several groups of employees who have never before received enhanced benefits. These employee groups that would traditionally have received normal retirement benefits at age 60, or age 65 in the case of Act 120 members, would instead be eligible for an early superannuation age with full retirement benefits. This broadening of the definition would apply to both current and future members of the System and would produce new, ongoing and unfunded liability costs to the System. Under Amendment Number 02717, psychiatric security aides, an employee group already categorized under "enforcement officers" in the SERS Code, would still be required to become mandatory participants in the new DC plan. The rationale for this group's inclusion in the DC plan while exempting all other public safety employees is unclear.

<u>Benefit Parity</u>. The special public safety employee benefit coverage (age 50 retirement for pre-Act 120 members and age 55 for Act 120 members) has been provided to Waterways Conservation Officers of the Pennsylvania Fish and Boat Commission who perform duties not substantially different from those performed by the Game Commission employees who are to receive the special public safety benefit coverage under the amendments.

<u>State Police, Enforcement Officers and Correction Officers Benefits</u>. The benefits of State Police officers are affected by the DiLauro arbitration award. The award provided that officers with 20 years of service are eligible to receive a retirement benefit of 50% of the officer's highest full year's salary, and those with 25 years of service shall receive 75% of the highest full year's salary. Years of service between 20 and 25 or after 25 do not produce incremental benefit increases. The award applies to officers who retire on or after July 1, 1989. (Class A members with less than 20 years of service are not affected by the award and are eligible for the statutory Class A benefit at a 2.0% benefit accrual rate. No State Police officer is entitled to the Act 9 benefit accrual rate of 2.5% because members of the State Police were specifically excluded from coverage by that

statute). By the act of August 5, 1991 [P. L. 183, No. 23], 71 Pa. C. S. § 5955 was amended to provide that SERS retirement benefits are exclusively statutory and cannot be changed by collective bargaining agreements or arbitration awards under such agreements. That section grandfathered pre-existing awards, including DiLauro, but the amendment does not foreclose the legislature from prospectively altering benefits for new State Police officers by statute. It is unclear why State Police, enforcement officers and correction officers are given special treatment in the amendments while other traditional, special membership classes are not exempt from the new DC plan.

Technical Operational Issues. In reviewing the amendments, the Commission staff noted the following technical operational issues.

Drafting Considerations. The amendments would amend the definition of "active participant" in the bill to exempt a member of the State Police, enforcement officer or correction officer from mandatory participation in the DC plan. The amendments do not make a corresponding amendment relating to the System membership and plan participation subsections of Section 5301 in the bill. By not amending the pertinent parts of Section 5301, the employee groups would still be included as participants in the DC plan, and consequently, may be excluded from receiving any pension at all.

If it is the intent of the amendments' sponsors to maintain membership in the DB plan for all current and prospective members of the State Police, enforcement officers and correction officers, then the amendments need to include conforming language in Section 5995(c) of the bill.

As it is written in Section 47 of the bill, any changes in the accrued liability resulting from changes in benefits are to be funded over 20 years and are subject to the collared contribution rate. Since the normal default rule under the SERS Code is that costs added by legislation are to be amortized over 10 years and are on top of the collared contribution rate, this change could result in increasing benefits for certain employee groups without paying for them for as long as the contribution rate collars are in effect.

Drafting Ambiguities. In the case of Amendment No. 02634, the definition of "active participant" exempts members of the State Police, enforcement officers and correction officers from participation in the DC plan, but the employee groups are still listed under "employer defined contributions," requiring employers to contribute 5.5% of pay on behalf of the employees. This is contradictory language that the amendment's sponsor may wish to address prior to further consideration.

The expanded definition of "enforcement officer" includes any police officer employed by other designated Commonwealth military installations and facilities, but the amendments do not designate which facilities those are.

In reviewing Amendment Number 02750, the Commission identified the following policy considerations.

State Police and Correction Officers Benefits. The benefits of State Police officers are affected by the DiLauro arbitration award. The award provided that officers with 20 years of service are eligible to receive a retirement benefit of 50% of the officer's highest full year's salary, and those with 25 years of service shall receive 75% of the highest full year's salary. Years of service between 20 and 25 or after 25 do not produce incremental benefit increases. The award applies to officers who retire on or after July 1, 1989. (Class A members with less than 20 years of service are not affected by the award and are eligible for the statutory Class A benefit at a 2.0% benefit accrual rate. No State Police officer is entitled to the Act 9 benefit accrual rate of 2.5% because members of the State Police were specifically excluded from coverage by that statute). By the act of August 5, 1991 [P. L. 183, No. 23], 71 Pa. C. S. § 5955 was amended to provide that SERS retirement benefits are exclusively statutory and cannot be changed by collective bargaining agreements or arbitration awards under such agreements. That section grandfathered pre-existing awards, including DiLauro, but the amendment does not foreclose the legislature from prospectively altering benefits for new State Police officers by statute. It is unclear why State Police and correction officers are given special treatment in the amendment while other traditional, special membership classes are not exempt from the new DC plan.

Technical Operational Issues. In reviewing the amendment, the Commission staff noted the following technical operational issues.

Drafting Considerations. The amendment would amend the definition of "active participant" in the bill to exempt a member of the State Police or a correction officer from mandatory participation in the DC plan. The amendment does not make a corresponding amendment relating to the System membership and plan participation subsections in Section 5301 of the bill. By not amending the pertinent parts of Section 5301, the employee groups are still included as participants in the DC plan, and consequently, may be excluded from receiving any pension at all.

If it is the intent of the amendment's sponsor to maintain membership in the DB plan for all current and prospective members of the State Police and correction officers, then the amendment needs to include conforming language in Section 5995(c) of the bill.

COMMISSION RECOMMENDATION

On September 18, 2013, the Commission voted to attach the actuarial note to the bill and amendments, recommending that the General Assembly and the Governor consider the policy issues identified in the actuarial note transmittal.

LEGISLATIVE STATUS AS OF DECEMBER 31, 2013

House Bill Number 1353, Printer's Number 2152, had first consideration on June 25, 2013, and was reported as committed from the House Rules Committee on September 23, 2013.

To view this note in its entirety, click the following link: Amendment Numbers 02634, 02717, and 02750 to House Bill Number 1353, Printer's Number 2152

PART II

PUBLIC EMPLOYEE RETIREMENT SYSTEM ADMINISTRATION

A. ACT 205 OF 1984.

- **2013 Filing Period**

In April of 2013, the Commission transmitted filing notices to the 4,500 local governments required to file employee pension plan reports pursuant to Act 205. A follow-up notice was sent to local governments that failed to respond to the filing notice and were known to have a pension plan. The filing deadline for the 2013 Act 205 reports will be March 31, 2014.

- **Municipal Pension Cost Certification**

In August of 2013, the Commission certified municipal pension cost data to the Department of the Auditor General for use in the 2013 allocation of General Municipal Pension System State Aid. In 2013, the State aid provided to municipalities to offset their employee pension costs totaled $247 million. More than 1,400 individual allocations of General Municipal Pension System State Aid were determined by the cost data certified by the Commission.

B. ACT 293 OF 1972.

- **2012 Filing Period**

Since the passage of the Municipal Pension Plan Funding Standard and Recovery Act, the actuarial reporting program under Act 293 has only been applicable to county employee retirement systems. The 2012 actuarial reports on these systems were filed in 2013. The financial, demographic, and actuarial data contained in the reports has been reviewed and will be summarized in the Status Report on Local Government Pension Plans to be published by the Commission late in 2014.

PART III

PUBLIC EMPLOYEE RETIREMENT SYSTEM POLICY DEVELOPMENT AND COORDINATION

A. STATUTORY PROVISIONS.

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

Section 6. Powers and Duties.

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

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

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

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

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

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

B. RESEARCH.

- **Pension Reform**

After releasing the Commission's report entitled *Special Report: Funding and Reforming Public Employee Retirement Systems*, in January of 2013, the Commission staff spent much of the legislative session in consultation with the Governor's administration, the legislature, and municipal associations on various pension reform proposals that would have the potential to address the current pension funding issues facing the Public School Employees'

B. RESEARCH. (CONT'D)

Retirement System, the State Employees' Retirement System, and local government pension plans. The actuarial notes included in this Annual Report represent only a fraction of the reform proposals that the Commission staff reviewed and offered insight into during the legislative session.

C. STATEWIDE PUBLIC EMPLOYEE RETIREMENT SYSTEM REVIEWS.

Under the Public Employee Retirement Commission Act, the Commission conducts periodic reviews of the actuarial and financial reports of the various public employee retirement systems. The Commission conducted its review of the Public School Employees' Retirement System in March 2013.

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

At the March 8, 2013, meeting of the Commission, the Staff presented a summary of the June 30, 2012, Actuarial Valuation Report of the Public School Employees' Retirement System (PSERS) issued January 15, 2013, 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 $85,751,641,000 to $87,854,413,000.
- A decrease in the actuarial value of assets from $59,252,389,000 to $58,321,375,000.
- An increase in unfunded actuarial accrued liability from $26,499,252,000 to $29,533,038,000 (total increase of $3,033,786,000).
- The unfunded accrued liability was $2,372,550,000 more than expected.
- A 2.7% decrease in the funded ratio from 69.1% to 66.4%.
- An increase in employer contributions for pensions of 4.5% (plus an increase of 0.07% to the health insurance contribution rate).
- Employer contributions for pension benefits are set at the collared rate of 16%, per Act 120 of 2010 as the maximum employer contribution rate, plus the 0.93% health insurance contribution rate for a total employer contribution rate of 16.93%.
- A decrease in the total normal cost from 16.06% to 16.00%.

Changes in Contribution Rate

		Employer Contributions (As a % of Payroll)				
Fiscal Year	Member Contributions	Normal Cost	Unfunded Accrued Liability	Health Insurance	Preliminary Employer Contribution	Final Employer Contribution*
2013/2014	7.43%	8.57%	15.25%	0.93%	24.75%	16.93%[1]
2012/2013	7.40%	8.66%	12.99%	0.86%	22.51%	12.36%[1]
2011/2012	7.37%	8.12%	10.15%	0.65%	18.92%	8.65%[1]
2010/2011	7.34%	8.08%	(0.50)%	0.64%	8.22%	5.64%[2]
2009/2010	7.32%	7.35%	(3.72)%	0.78%	4.41%	4.78%[3]

* Certified by the Board.
[1] Reflects Act 120 Pension Collar.
[2] Reflects Act 46.
[3] Reflects Act 40 Pension Floor.

Reasons for Change in the Contribution Rate

– Fiscal Year 2012/2013 Act 120 final rate	12.36%
– Deferral of Fiscal Year 2013 pension contribution due to Act 120 3.5% collar	10.15
– Fiscal Year 2012/2013 actual rate	22.51%
– Decrease due to change in normal rate	(0.09)
– Net increase due to payroll growth and liability experience*	0.72
– Increase due to actuarial loss on assets	0.78
– Increase due to deferral of Fiscal Year 2012 pension contribution due to Act 120 3.0% collar	0.76
– Deferral of Fiscal Year 2014 pension contribution due to Act 120 4.5% collar	(7.82)
– Increase due to change in health insurance contribution rate	0.07
Total Fiscal Year 2013/2014 Employer Rate	16.93%

* Reflects increase from appropriation payroll less than expected partially offset by liability gains.

Reasons for Change Greater Than Expected in Unfunded Actuarial Accrued Liability

▸ Experience (Gains) Losses	
– Loss from investment return on actuarial value of assets	$1,493,512,000
– Gain from salary increases less than expected	(491,780,000)
– Loss from new entrants and pickups	211,159,000
– Gain from vested termination experience (retirement/disability/termination)	(306,792,000)
– Gain from non-vested termination experience	(89,100,000)
– Gain from data/miscellaneous	(31,119,000)
– Loss from mortality experience	137,368,000
Sub-Total:	$923,248,000
▸ Change due to Act 120 3.0% collar on Fiscal Year 2012 pension contribution	$1,449,302,000
Grand Total:	$2,372,550,000

* * * * * * * * * *

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, 2012

The following is a summary of the June 30, 2012, Actuarial Valuation of the Public School Employees' Retirement System and a comparison of the 2012 results with those of 2011.

	6/30/12		6/30/11	
Membership				
Active Members	273,504		279,152	
Inactive and Vested Members	122,286		115,102	
Retired Members	182,254		175,636	
Disabled Members	8,306		8,029	
Survivors and Beneficiaries	11,455		10,957	
Payroll and Annuities Payable				
Total Annualized Payroll	$12,714,371,000		$12,910,043,000	
Annual Annuities and Benefits	$ 4,872,918,000		$ 4,650,798,000	
Valuation Data				
Accrued Liability [1]	$87,854,413,000		$85,751,641,000	
Actuarial Value of Assets	58,321,375,000		59,252,389,000	
Unfunded Accrued Liability [1]	$29,533,038,000		$26,499,252,000	
Fund Ratio (Pensions and Health Insurance Combined)	66.4%		69.1%	
Funding Costs				
Total Normal Cost	$2,034,299,360	16.00 %	$2,073,352,906	16.06%
Amortization [2]	2,092,693,000	15.25 %	1,856,957,000	12.99%
Full Actuarial Funding	$4,031,634,578	31.25 %	$3,930,309,906	29.05%
Support				
Member	$ 944,677,765	7.43 %	$ 955,343,182	7.40%
Employer [3]	2,152,543,010	16.93 %	1,595,681,315	12.36%
Total Support	$3,097,220,776	24.36 %	$2,551,024,497	19.76%

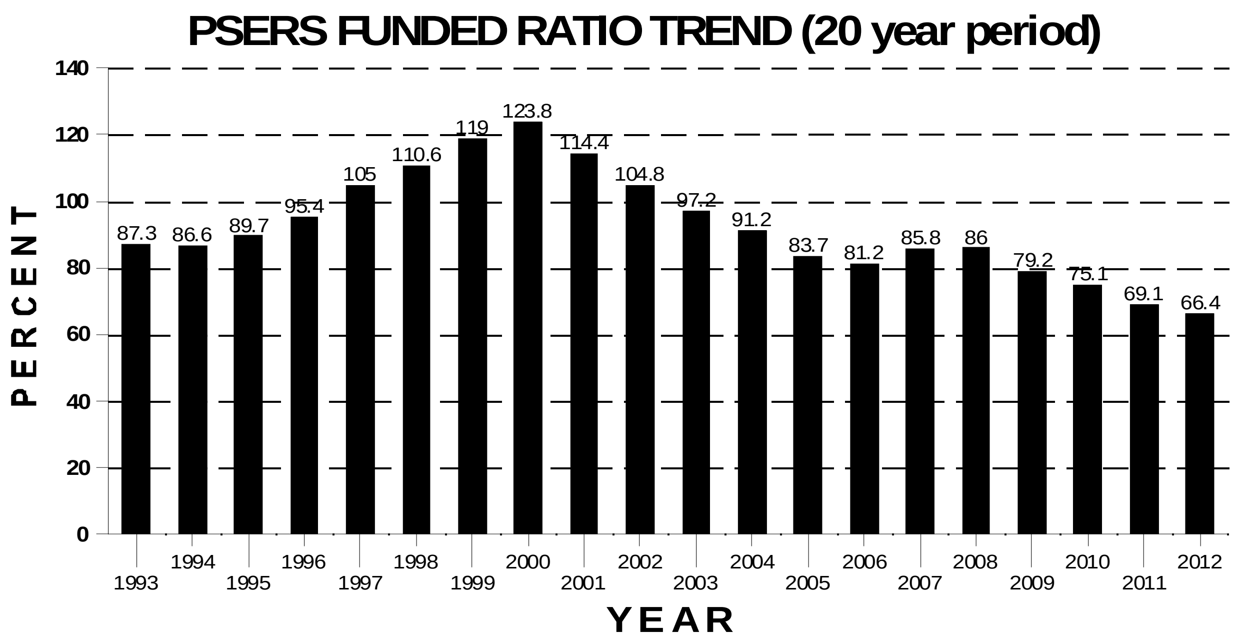
[1] Includes liability for health care payments.

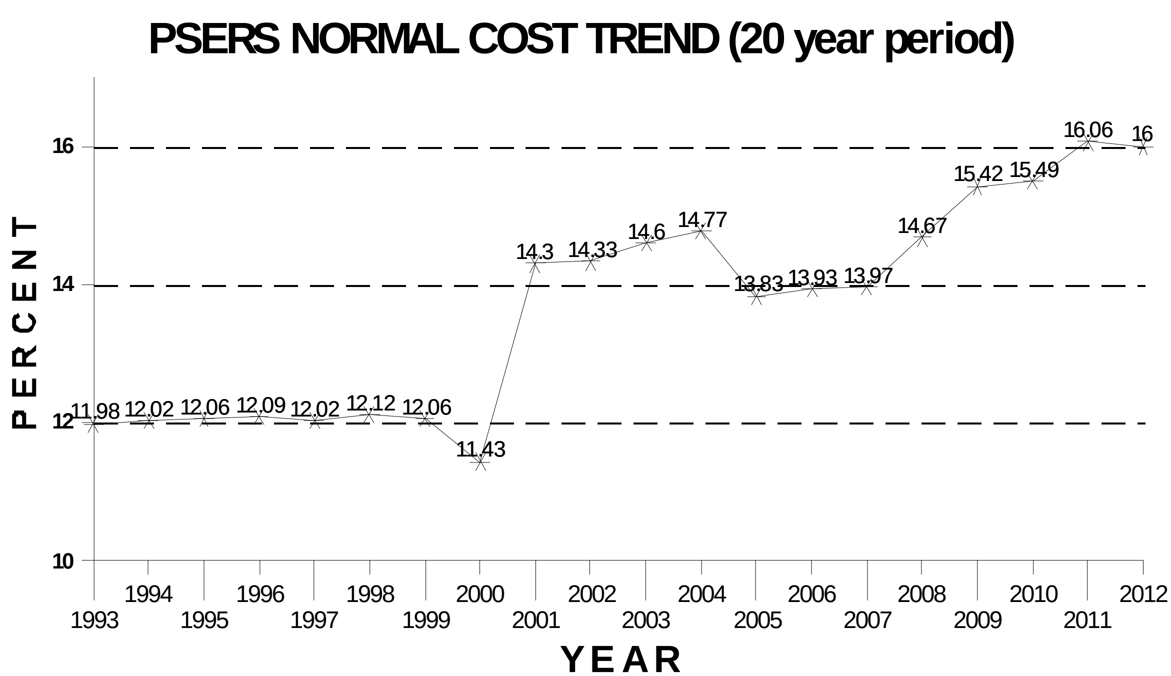
[2] Act 120 of 2010 amended the amortization schedule. The unfunded actuarial accrued liability is re-amortized as of the June 30, 2010, valuation, including the cost of Act 120, over a 24-year period with the amortization payments determined as a level percentage of pay. Future valuation experience gains or losses, and changes in the unfunded accrued liability resulting from changes in actuarial assumptions and methods, will be amortized over a 24-year period as a level percentage of pay. Future increases in accrued liability enacted by legislation after June 30, 2010, will be funded over a 10-year period as a level percentage of pay.

Note: Amortization payments calculated based upon estimated employer payroll. See Table 2, Page 12.

[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 56%/44% 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 contribution rate of 16.0% for Fiscal Year 2013-2014 reflects the Act 120 collar of 4.5%. The employer health-care contribution rate for Fiscal Year 2013-2014 is 0.93%.


PSERS FUNDED RATIO TREND (20 year period)
PERCENT
YEAR
0
20
40
60
80
100
120
140
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 75.1 69.1 66.4
1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012


PSERS NORMAL COST TREND (20 year period)
PERCENT
YEAR
10
12
14
16
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 15.49 16.06 16
1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012

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 2013 and their sponsoring organizations were as follows:

MUNICIPAL PENSION ADVISORY COMMITTEE

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

Mr. A. Christopher Cap
PENNSYLVANIA STATE ASSOCIATION OF BOROUGHS

Ms. Amy C. Sturges
PENNSYLVANIA MUNICIPAL LEAGUE

Mr. Michael J. Dennehy, Jr.
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. Michael Maguire
AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

Mr. David Spotts
PENNSYLVANIA CHIEFS OF POLICE ASSOCIATION

Mr. Steven R. Nickol
PENNSYLVANIA STATE EDUCATION ASSOCIATION

ADVISORY COMMITTEES AND CONSULTING ACTUARIES (Cont'd)

Consulting Actuaries

The actuarial services committee developed and adopted guidelines for providing actuarial services to the Commission on June 2, 1982. The guidelines establish the educational and experience standards for the selection of consulting actuaries. The engagement of multiple actuarial consultants was considered appropriate to provide the Commission with an enhanced scope of actuarial experience and a greater response capacity, and to avoid potential conflicts of interest. The actuarial consultants engaged by the Commission during 2013 were:

Conrad Siegel Actuaries
Mr. David H. Killick

Milliman, Inc.
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 2013 - 2014 SESSIONS LEGISLATION REGARDING PUBLIC EMPLOYEE RETIREMENT ISSUES AS OF DECEMBER 31, 2013

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
H. B. 79 P. N. 58 (Harper)	The bill would amend the Constitution of the Commonwealth to increase the mandatory retirement age for justices, judges and justices of the peace from age 70 to age 75.	Introduced and referred to House Judiciary Committee **Commission Letter (P. N. 58)** First Consideration Second Consideration Re-referred to House Appropriations Committee Third Consideration and Final Passage (156-44) Referred to Senate Judiciary Committee First Consideration Second Consideration Third Consideration and Final Passage (44-6) Joint Resolution #3 of 2013	01/10/13 03/08/13 05/14/13 06/24/13 06/24/13 06/28/13 06/30/13 10/01/13 10/02/13 10/15/13 10/24/13
H. B. 128 P. N. 126 (Haggerty)	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 Urban Affairs Committee First Consideration **Commission Letter (P. N. 126)** Second Consideration Re-referred to House Appropriations Committee Third Consideration and Final Passage (196-0) Referred to Senate Finance Committee	01/16/13 06/03/13 06/04/13 06/17/13 06/17/13 06/18/13 06/24/13
H. B. 131 P. N. 128 (Haggerty)	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 Urban Affairs Committee First Consideration **Commission Letter (P. N. 128)** Second Consideration Re-referred to House Appropriations Committee Third Consideration and Final Passage (196-0) Referred to Senate Finance Committee	01/16/13 06/03/13 06/04/13 06/17/13 06/17/13 06/18/13 06/24/13
H. B. 136 P. N. 130 (Keller, F.)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding definitions for "felony offense" and "crime of violence."	Introduced and referred to House State Government Committee First Consideration	01/16/13 03/12/13
H. B. 240 P. N. 253 (Petri)	PSERS, amending the Code to establish an optional defined contribution plan to be known as the Public School Employees' Optional Retirement Program for school employees hired on or after January 1, 2014.	Introduced and referred to House State Government Committee	01/23/13
H. B. 242 P. N. 255 (Petri)	SERS, amending the Code to establish an optional defined contribution plan to be known as the State Employees' Optional Re-	Introduced and referred to House State Government Committee	01/23/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
	tirement Program for school employees hired on or after January 1, 2014.		
H. B. 253 P. N. 265 (Boyle)	Emergency and Law Enforcement Death Benefits Act (Act 101 of 1976), providing a death benefit for the spouse or beneficiary of a natural gas responder killed in the performance of duty.	Introduced and referred to House Veterans Affairs Emergency Preparedness Committee	01/23/13
H. B. 356 P. N. 369 (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	01/29/13
H. B. 413 P. N. 423 (Krieger)	SERS, establishing a new voluntary retirement program applicable to any state legislator who first becomes a member of the General Assembly on or after December 1, 2014, or who is re-elected to serve as a member of the General Assembly beginning on or after December 1, 2014. Membership in the State Employees' Retirement System (SERS) would be prohibited for a state legislator who first becomes a member of the General Assembly on or after December 1, 2014. A current member who is re-elected to serve in the General Assembly beginning on or after December 1, 2014, would cease accruing service credit in SERS as of November 30, 2014, but would have the opportunity to elect membership in the new retirement program.	Introduced and referred to House State Government Committee	01/29/13
H. B. 500 P. N. 522 (Sainato)	Emergency and Law Enforcement Death Benefits Act (Act 101 of 1976), providing a death benefit for the spouse or beneficiary of a member of the Pennsylvania Civil Air Patrol.	Introduced and referred to House Veterans Affairs and Emergency Preparedness Committee First Consideration	02/04/13 02/11/13
H. B. 546 P. N. 2595 (Turzai)	Second Class County Code, amending the definition of "compensation" to exclude overtime pay in excess of 10% of pay from the calculation of a member's retirement benefit; increasing the superannuation requirement for new members to age 60 with 25 years of service; increasing the vesting period to 10 years; further providing for the calculation of retirement allowances; and further providing for membership of the Allegheny County Retirement Board.	Introduced and referred to House Finance Committee First Consideration **Actuarial Note (P. N. 580)** Second Consideration Re-referred to House Appropriations Committee Third Consideration and Final Passage (189-7) Referred to Senate Finance Committee Reported as amended First Consideration **Commission Letter (P. N. 2595)** Second Consideration Re-referred to Senate Appropriations Committee Third Consideration and Final Passage (50-0) Re-referred to House Rules Committee House concurred in Senate amendments (194-3) Signed by the Governor (Act 125 of 2013)	02/05/13 02/06/13 03/08/13 03/12/13 03/12/13 03/13/13 03/15/13 10/23/13 10/23/13 10/24/13 11/13/13 11/13/13 12/10/13 12/11/13 12/16/13 12/23/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
H. B. 567 P. N. 629 (Sonney)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), amending the special municipal taxing authority for financially distressed municipal pension systems to tax only residents of the municipality.	Introduced and referred to House Finance Committee	02/08/13
H. B. 686 P. N. 783 (Goodman)	PSERS, expanding the membership of the PSERS Board of Trustees and providing for the appointment of designees.	Introduced and referred to House Education Committee	02/13/13
H. B. 711 P. N. 803 (Baker)	Pennsylvania Conservation Corps Act (Act 112 of 1984), beginning July 1, 2013, providing for 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	02/13/13
H. B. 712 P. N. 804 (Baker)	PSERS and SERS, beginning July 1, 2011, amending the SERS Code to provide for optional membership in SERS for "crewleaders" employed pursuant to the PA Conservation Corps Act (Act 112 of 1984). The bill also amends the PSERS and SERS Codes to provide for the purchase of up to five years of nonschool or nonstate service credit for service as a crewleader with the PA Conservation Corps rendered prior to July 1, 2011, provided the member elects to purchase the service within three years of becoming eligible to do so and the member pays the full actuarial cost of the benefit enhancement.	Introduced and referred to House State Government Committee	02/13/13
H. B. 761 P. N. 873 (Evankovich)	SERS, amending the Code to establish an optional defined contribution plan to be known as the Legislative Agency Official and Employee Defined Contribution Benefit Program, a voluntary retirement program applicable to members of the General Assembly or employees of a legislative agency who first become members of the System on or after November 30, 2014.	Introduced and referred to House State Government Committee	02/25/13
H. B. 1021 P. N. 1214 (Simmons)	PSERS and SERS, beginning with the 2012-2013 fiscal year, if there is a surplus in the General Fund at the end of the fiscal year, 50% of the surplus shall be transferred in proportion to the current unfunded actuarial accrued liabilities of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS).	Introduced and referred to House Appropriations Committee	03/19/13
H. B. 1037 P. N. 1235 (Mullery)	SERS, amending the definition of "enforcement officer" to include officers of the Pennsylvania Game Commission.	Introduced and referred to House State Government Committee	03/20/13
H. B. 1132 P. N. 1381 (Mundy)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding to the list of criminal offenses any offense relating to theft by unlawful taking or disposition.	Introduced and referred to House State Government Committee	04/08/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
H. B. 1134 P. N. 1383 (Grell)	PSERS, amending the Military and PSERS Codes to bring PSERS into compliance with the following Federal laws: 1) the Heroes Earning Assistance and Relief Tax Act of 2008 (HEART Act); 2) the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA); and 3) Internal Revenue Code Section 414(u) [IRC §414(u)].	Introduced and referred to House Finance Committee	04/08/13
H. B. 1204 P. N. 1509 (Grell)	PSERS, amends Section 8507(h) of the PSERS Code to insure a member's eligibility to collect an annuity and preserves the tax-qualified status of PSERS.	Introduced and referred to House Education Committee	04/16/13
H. B. 1277 P. N. 1999 (Adolph)	SERS, making an appropriation from the State Employees' Retirement Fund in the amount of $21,002,000, to provide for expenses of the State Employees' Retirement Board for the fiscal year beginning July 1, 2013.	Introduced and referred to House Appropriations Committee	04/30/13
		Reported as amended	06/10/13
		First Consideration	06/10/13
		Re-referred to House Rules Committee	06/10/13
		Second Consideration	06/19/13
		Re-referred to House Appropriations Committee	06/19/13
		Third Consideration and Final Passage (199-0)	06/27/13
		Referred to Senate Appropriations Committee	06/28/13
		First Consideration	06/28/13
		Second Consideration	06/29/13
		Third Consideration and Final Passage (50-0)	06/30/13
		Signed by the Governor (Act 4A of 2013)	07/09/13
H. B. 1278 P. N. 2000 (Adolph)	PSERS, making an appropriation from the Public School Employees' Retirement Fund in the amount of $41,689,000, to provide for expenses of the Public School Employees' Retirement Board for the fiscal year beginning July 1, 2013.	Introduced and referred to House Appropriations Committee	04/30/13
		Reported as amended	06/10/13
		First Consideration	06/10/13
		Re-referred to House Rules Committee	06/10/13
		Second Consideration	06/19/13
		Re-referred to House Appropriations Committee	06/19/13
		Third Consideration and Final Passage (199-0)	06/27/13
		Referred to Senate Appropriations Committee	06/28/13
		First Consideration	06/28/13
		Second Consideration	06/29/13
		Third Consideration and Final Passage (50-0)	06/30/13
		Signed by the Governor (Act 5A of 2013)	07/09/13
H. B. 1323 P. N. 1704 (Briggs)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), amending the definition of "professional services contract" to exclude municipal pension systems with less than 100 active members.	Introduced and referred to House Local Government Committee	05/06/13
H. B. 1350 P. N. 1760 (Ross)	PSERS and SERS, amending the Codes of both Systems to: 1) Modify the employer contribution limits to PSERS and SERS enacted	Introduced and referred to House State Government Committee	05/09/13
		Advisory Note (P. N. 1760)	05/31/13

under Act 120 of 2010, by further limiting the rate at which employer contributions may rise from year to year. The bill proposes to reduce the current collared contribution rate of 4.5% for the upcoming fiscal year to 2.25%, and to further limit the contribution rate increase by no more than 0.50% per year until July 1, 2018, at which point the collared contribution rate returns to the 4.5% collared rate; 2) Effective July 1, 2015, establish a defined contribution retirement benefit plan under a new chapter of the PSERS Code, Chapter 84, called the School Employees' Defined Contribution (DC) Plan. All new school employees or employees returning after a break in service would become participants in the new plan. Membership in the PSERS' defined benefit retirement plan would be closed to all new or returning employees. School employees participating in the DC plan would contribute 7.5% of compensation with an employer contribution of 4% of compensation; 3) Effective January 1, 2015, establish a defined contribution retirement benefit plan under a new chapter of the SERS Code, Chapter 54, called the State Employees' Defined Contribution (DC) Plan. Most new State employees or employees returning after a break in service will become participants in the new plan. Membership in the SERS' defined benefit retirement plan would be closed to all new or returning employees. Most State employees participating in the DC plan would contribute 6.25% of pay with an employer contribution of 4% of compensation. For hazardous duty employees (excluding Capitol police and park rangers), the employer contribution rate would be 5.5% of compensation. For State police officers, the employer contribution rate would be 12.2% of compensation; 4) Modify benefits for active members of both Systems (with the exception of members subject to Act 120 of 2010) by creating new classes of membership for current school and State employees effective July 1, 2015, in the case of PSERS, and January 1, 2015, in the case of SERS. Most current members in PSERS would receive a reduced benefit accrual rate of 2.0% with a corresponding employee contribution of 7.5% of compensation. Most current members in SERS would receive a reduced benefit accrual rate of 2.0% with a corresponding employee contribution of 6.25% of compensation. The new classes of service would be for prospective service only; 5) For current members of both Systems who select the Option 4 lump-sum withdrawal upon retirement after July 1, 2015, in the case of PSERS, and January 1, 2015, in the case of

Addendum to Advisory Note (P. N. 1760) — 06/11/13

	SERS, modify the manner of determining the net annuity to make the option actuarially cost neutral to the Systems for all employee contributions made after the year 2015; 6) For all service performed or first credited on or after July 1 ,2015, in PSERS, and January 1, 2015, in SERS, modify the calculation of "Final Average Salary" from the average of the highest three years of service to the average of the highest five years; 7) Further limit pensionable compensation for members to not exceed 110% of the average of the four preceding years of pensionable compensation for Final Average Salary calculation purposes; and 8) Cap the pensionable compensation for Final Average Salary at the Social Security wage base ($113,700 in 2013).		
H. B. 1352 P. N. 2151 (Kampf)	PSERS, amending the Public School Employees' Retirement Code to: 1) Add a new chapter, Chapter 84, titled "School Employees' Defined Contribution Plan." Chapter 84 would establish a mandatory defined contribution plan for public school employees whose most recent period of public school service starts on or after July 1, 2015. Employer contributions to the plan would be equal to 4% of salary, with a mandatory employee contribution of 4% of salary; 2) Permit current PSERS members to elect to participate in the defined contribution plan prospectively, with a 4% employer contribution and 4% employee contribution for all subsequent school service; 3) Modify the calculation of "final average salary" applicable to current PSERS members from the average of the highest three years of service to the average of the highest five years for all service performed or first credited on or after July 1, 2015; 4) For service performed or credited to current members on or after July 1, 2015, further limit pensionable compensation to not exceed 110% of the average of the four preceding years of pensionable compensation for final average salary calculation purposes; and 5) For current members of the System who elect the Option 4 lump-sum withdrawal upon retirement after July 1, 2015, modify the manner of determining the net annuity to make the option actuarially cost neutral to the System for all employee contributions made after the year 2015.	Introduced and referred to House State Government Committee **Actuarial Note (P. N. 1846)** Reported as amended First Consideration Re-referred to House Rules Committee	05/17/13 06/25/13 06/25/13 06/25/13 06/25/13
H. B. 1353 P. N. 2152 (Kampf)	SERS, amending the State Employees' Retirement Code to: 1) Add a new chapter, Chapter 54, titled "State Employees' Defined Contribution Plan." Chapter 54 would establish a mandatory defined contribution plan for state employees whose most recent peri-	Introduced and referred to House State Government Committee Reported as amended First Consideration **Actuarial Note (P. N. 1847)** Re-referred to House Rules Committee	05/17/13 06/25/13 06/25/13 06/25/13 06/25/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
	od of state service starts on or after January 1, 2015. Employer contributions to the plan would be equal to 4% of salary for most employees, with a mandatory employee contribution of 4% of salary; 2) Permit current SERS members to elect to participate in the defined contribution plan prospectively, with a 4% employer contribution and 4% contribution for all subsequent state service; 3) For current members of the System who elect the Option 4 lump-sum withdrawal upon retirement after January 1, 2015, modify the manner of determining the net annuity to make the option actuarially cost neutral to the System for all employee contributions made after the year 2015; 4) Modify the calculation of "final average salary" applicable to current SERS members from the average of the highest three years of service to the average of the highest five years for all service performed or first credited on or after January 1, 2015; and 5) For service performed or credited to current members on or after January 1, 2015, limit pensionable compensation for members to not exceed 110% of the average of the four preceding years of pensionable compensation for final average salary calculation purposes.	**Commission Letter (A. 02680)** **Commission Letter (A. 02735)** **Commission Letter (A. 02782)** **Actuarial Note (A. 02634, 02717, 02750)** **Commission Letter (A. 02775)** **Commission Letter (A. 02777)** **Commission Letter (A. 02758)** **Commission Letter (A. 02761)** **Commission Letter (A. 02766)** **Commission Letter (A. 02773)**	09/12/13 09/12/13 09/12/13 09/18/13 09/24/13 09/24/13 10/10/13 10/10/13 10/10/13 10/10/13
H. B. 1405 P. N. 1828 (Tallman)	An Act, creating the School Pension Liability Assistance Act, to provide monies to school districts based on the total pension liability of a school district and the local taxing effort of the local school district. The School Pension Liability Assistance Fund will be funded through appropriations and return on the money in the fund.	Introduced and referred to House Education Committee	05/15/13
H. B. 1453 P. N. 1881 (Caltagirone)	An Act, establishing the Public School Employees' Benefit Board as an independent administrative board for public school employees and annuitants. The Act would require the Board to do the following: 1) Conduct a school employee health benefits study; 2) Examine future cost forecasts and collect data necessary to create a program that will reduce long-term costs for public school entities; and 3) Provide for a statewide health benefit program and a retirement health savings program.	Introduced and referred to House Education Committee	05/28/13
H. B. 1471 P. N. 1911 (McGinnis)	PSERS and SERS, requiring that the annual financial statements for both Systems include a "mark-to-market" balance sheet, and the discount rate used to determine the market value of each System's liabilities on the balance sheet shall be the yield on 20-year U.S. Treasury Separate Trading of Registered Interest and Principal Securities (STRIPS).	Introduced and referred to House State Government Committee **Commission Letter (P. N. 1911)**	06/03/13 06/14/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
H. B. 1496 P. N. 1978 (Haluska)	SERS, authorizing the purchase of nonstate service credit for certain previous employment in the mining industry.	Introduced and referred to House State Government Committee	06/10/13
H. B. 1518 P. N. 2025 (O'Neill)	PSERS, amending the Code to: 1) credit the annuity reserve account with "actual interest," which the bill defines as the difference between the Fund's earnings and the actuarial assumed rate of return (currently 7.5%), instead of the currently mandated "valuation interest," defined in the Code as 5.5% and which is credited to all accounts (including the annuity reserve account) except for the members' savings account which is credited at 4%; 2) changing the amortization period for COLA liabilities from the currently mandated 10-year level dollar to 20-year level dollar; and 3) beginning July 1, 2004, and annually thereafter, provide an automatic COLA to all annuitants of the System who retired on or before July 1, 2014, and equal to the lesser of 3% or the increase in CPI during the previous year.	Introduced and referred to House State Government Committee	06/12/13
H. B. 1545 P. N. 2149 (Boback)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding to the list of criminal offenses several offenses committed against the elderly or children. The bill also amends the act to require public employees or public officials who upon entering a plea of guilty or are found guilty by a jury to forfeit their pension benefits.	Introduced and referred to House Judiciary Committee Reported as amended First Consideration Re-referred to House Rules Committee	06/18/13 06/25/13 06/25/13 06/25/13
H. B. 1581 P. N. 2146 (Grove)	An Act, establishing a new "cash balance" retirement benefit plan applicable to all full-time police officers and firefighters hired by boroughs, townships and cities (except for the City of Philadelphia) within the Commonwealth on or after January 1, 2013. Member contributions would be equal to 6% of pay for members participating in Social Security and 9% of pay for members not participating in Social Security. The employer "crediting rate" would be equal to 4.5% of pay. Members would become fully vested in the employer contributions after 12 years of service. Members would attain superannuation age upon age 55 with 25 years of service. Existing municipal defined benefit plans would be closed to any new members after the effective date of the act. Current members of the plans would be unaffected by the new cash balance plan.	Introduced and referred to House Finance Committee Re-referred to House Local Government Committee **Advisory Note (P. N. 2146)**	06/25/13 09/30/13 12/24/13
H. B. 1611 P. N. 2222 (Daley)	SERS, permits an active member of SERS to retire during the period of February 28, 2014, through June 2, 2014, 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	Introduced and referred to House Finance Committee Re-referred to House State Government Committee	07/15/13 09/30/13

	is under superannuation age. The bill would entitle an eligible member to insurance coverage under 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.		
H. B. 1612 P. N. 2223 (Daley)	PSERS, permits active members of PSERS to retire during the period of February 28, 2014, through June 2, 2014, 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 insurance coverage under a 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.	Introduced and referred to House Finance Committee	07/15/13
H. B. 1645 P. N. 2268 (Gibbons)	PSERS and SERS, providing a supplemental annuity (COLA) to eligible annuitants, commencing with the first monthly annuity payment after July 1, 2013, 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 annuitant is defined as any superannuation, withdrawal or disability annuitant who is receiving an annuity on July 1, 2012, 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.	Introduced and referred to House State Government Committee	08/23/13
H. B. 1651 P. N. 2282 (Grell)	An Act, amending the Pennsylvania Municipal Retirement Law (Act 15 of 1974) to establish the Statewide Municipal Police Officers Pension Plan. The plan would require mandatory membership as an Article IV-A member for any municipal police officers hired on or after January 1, 2014, excluding police officers hired by a city of the first or second class. Employer contributions to the plan would be equal to 7.5% of salary, with a mandatory employee contribution of 7.5% of salary. An Article IV-A member would be eligible for an annual benefit accrual rate of 2.5%, not to exceed 65% of the member's	Introduced and referred to House Local Government Committee **Advisory Note (P. N. 2282)**	08/29/13 11/07/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
	final salary. Membership in the plan for municipal police officers hired on or before December 31, 2013, will be optional.		
H. B. 1708 P. N. 2391 (Tobash)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), amending the act to provide, beginning in fiscal year 2013-14 and each year thereafter, up to 0.25% of the amount deposited in the General Municipal Pension System State Aid Program to the Public Employee Retirement Commission for the costs and expenses directly related to the Commission's duties. The bill would also amend the act to exclude municipal pension systems with less than 100 active members from being required to develop and implement bidding procedures for entering into professional services contracts.	Introduced and referred to House Local Government Committee	09/26/13
H. B. 1752 P. N. 2467 (Murt)	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 Local Government Committee **Advisory Note (P. N. 2467)**	10/11/13 12/24/13
H. B. 1849 P. N. 2703 (Barbin)	PSERS and SERS, amending the Act of June 9, 1936, known as the Johnstown Flood Tax Act, to provide for the funds collected by the tax from January 1, 2016, through December 31, 2020, to be distributed equally between the State Employees' Retirement Fund and the Public School Employees' Retirement Fund. The bill would phase out the collection of the tax by January 1, 2021.	Introduced and referred to House Liquor Control Committee	11/21/13
H. B. 1927 P. N. 2834 (Gibbons)	SERS, permitting the purchase of up to five years of nonstate service credit by a member of the Pennsylvania State Police for previous service as a municipal police officer.	Introduced and referred to House State Government Committee	12/19/13
H.R. 88 P. N. 716 (Milne)	A resolution directing the Public Employee Retirement Commission (PERC), along with PSERS and SERS, to conduct a comprehensive study of the respective State-sponsored pension systems.	Introduced and referred to House State Government Committee	02/11/13
S. B. 2 P. N. 183 (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 newly hired school and state employees and employees reentering public service after December 31, 2013. The new retirement system established by the bill, known as the Public Employees' Retirement System (PERS), would be a defined contribution (DC) pension plan with an employer matching 6% contribution rate.	Introduced and referred to Senate Finance Committee	01/22/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
S. B. 147 P. N. 100 (Ward)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding to the list of criminal offenses any offense relating to the unlawful contact with a minor, reaching a felony level of third degree or higher.	Introduced and referred to Senate Finance Committee	01/15/13
S. B. 283 P. N. 202 (White, D.)	SERS, establishing a new voluntary retirement program applicable to any state legislator who first becomes a member of the General Assembly on or after December 1, 2014, or who is re-elected to serve as a member of the General Assembly beginning on or after December 1, 2014. Membership in the State Employees' Retirement System (SERS) would be prohibited for a state legislator who first becomes a member of the General Assembly on or after December 1, 2014. A current member who is re-elected to serve in the General Assembly beginning on or after December 1, 2014, would cease accruing service credit in SERS as of November 30, 2014, but would have the opportunity to elect membership in the new retirement program.	Introduced and referred to Senate Finance Committee	01/24/13
S. B. 289 P. N. 208 (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	01/24/13
S. B. 319 P. N. 230 (Farnese)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding to the list of criminal offenses any offense that requires registration under 42 PA.C.S. Sec. 9795.1 (relating to registration).	Introduced and referred to Senate Finance Committee	01/25/13
S. B. 396 P. N. 332 (Solobay)	SERS, permitting the purchase of nonstate service for certain periods of previous service as a mine worker.	Introduced and referred to Senate Finance Committee	02/04/13
S. B. 447 P. N. 393 (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 Senate Finance Committee	02/07/13
S. B. 456 P. N. 1251 (Blake)	An Act, amending the Tax Reform Code of 1971 to establish the "Innovate in PA" program which would provide for the structured auctioning of insurance premium tax credits. Auction proceeds would then be distributed to a number of economic development programs. The bill contains a "hold harmless" provision that would require the State Treasurer to transfer from the General Fund into the General Municipal Pension System State Aid revenue account under Section 402(b) of Act 205 an amount equal to the amount of tax credits claimed by insurance	Introduced and referred to Senate Finance Committee Reported as amended First Consideration **Commission Letter (P. N. 1251)** Second Consideration Re-referred to Senate Appropriations Committee	04/01/13 06/19/13 06/19/13 06/20/13 06/20/13 06/24/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
	companies who pay the Foreign Casualty Insurance Premium Tax and Foreign Fire Insurance Premium Tax.		
S. B. 463 P. N. 584 (Stack)	Emergency and Law Enforcement Death Benefits Act (Act 101 of 1976), providing a death benefit for the spouse or beneficiary of a natural gas responder killed in the performance of duty.	Introduced and referred to Senate Veteran Affairs and Emergency Preparedness Committee	03/06/13
S. B. 493 P. N. 457 (Vance)	Public Employee Pension Forfeiture Act (Act 140 of 1978), amending the act by adding definitions for "infamous crime."	Introduced and referred to Senate Finance Committee	02/13/13
S. B. 703 P. N. 708 (Blake)	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 **Actuarial Note (P. N. 708)** First Consideration Re-referred to Senate Appropriations Committee Second Consideration Third Consideration and Final Passage (50-0) Referred to House Urban Affairs Committee	03/15/13 05/16/13 10/02/13 10/22/13 12/03/13 12/10/13 12/12/13
S. B. 704 P. N. 709 (Blake)	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 **Actuarial Note (P. N. 709)** First Consideration Re-referred to Senate Appropriations Committee Second Consideration Third Consideration and Final Passage (50-0) Referred to House Urban Affairs Committee	03/15/13 05/16/13 10/02/13 10/22/13 12/03/13 12/10/13 12/12/13
S. B. 730 P. N. 762 (McIlhinney)	SERS, amending the definition of "enforcement officer" to include officers of the Pennsylvania Game Commission.	Introduced and referred to Senate Finance Committee	03/26/13
S. B. 742 P. N. 772 (Leach)	Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984), amending the definition of "professional services contract" to exclude municipal pension systems with less than 100 active members.	Introduced and referred to Senate Finance Committee **Actuarial Note (P. N. 772)**	03/26/13 05/16/13
S. B. 791 P. N. 812 (Costa)	Second Class County Code, amending the definition of "compensation" to exclude overtime pay in excess of 10% of pay from the calculation of a member's retirement benefit; increasing the superannuation requirement for new members to age 60 with 25 years of service; increasing the vesting period to 10 years; further providing for the calculation of retirement allowances; and further providing for membership of the Allegheny County Retirement Board.	Introduced and referred to Senate Finance Committee **Actuarial Note (P. N. 812)**	04/01/13 09/18/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
S. B. 797 P. N. 1148 (Browne)	PSERS, amending the Military and PSERS Codes to bring PSERS into compliance with the following Federal laws: 1) the Heroes Earning Assistance and Relief Tax Act of 2008 (HEART Act); 2) the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA); and 3) Internal Revenue Code Section 414(u) [IRC §414(u)].	Introduced and referred to Senate Finance Committee	04/01/13
		First Consideration	05/01/13
		Re-referred to Senate Appropriations Committee	05/06/13
		Actuarial Note (P. N. 817)	05/16/13
		Reported as amended	06/03/13
		Commission Letter (P. N. 1148)	06/04/13
		Second Consideration	06/04/13
		Third Consideration and Final Passage (50-0)	06/05/13
		Referred to House Finance Committee	06/10/13
		First Consideration	06/18/13
		Second Consideration	06/20/13
		Re-referred to House Appropriations Committee	06/20/13
		Third Consideration and Final Passage (202-0)	06/29/13
		Signed by the Governor (Act 32 of 2013)	07/01/13
S. B. 798 P. N. 818 (Browne)	PSERS, entitling members of the System who are granted leave for military service on or after July 1, 2013, to receive credit in PSERS for the leave.	Introduced and referred to Senate Finance Committee	04/01/13
		First Consideration	05/01/13
		Re-referred to Senate Appropriations Committee	05/06/13
		Actuarial Note (P. N. 818)	05/16/13
		Second Consideration	06/04/13
		Third Consideration and Final Passage (50-0)	06/05/13
		Referred to House Finance Committee	06/10/13
		First Consideration	06/18/13
		Second Consideration	06/20/13
		Re-referred to House Appropriations Committee	06/20/13
		Third Consideration and Final Passage (202-0)	06/29/13
		Signed by the Governor (Act 33 of 2013)	07/01/13
S. B. 887 P. N. 987 (Kasunic)	PSERS and SERS, mandating the payment of annual CPI-based COLAs to eligible annuitants of both Systems beginning July 1, 2013.	Introduced and referred to Senate Finance Committee	04/26/13
S. B. 888 P. N. 988 (Kasunic)	PSERS and SERS, amending the Codes of both systems to, beginning July 1, 2011, 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	04/26/13
S. B. 890 P. N. 990 (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;	Introduced and referred to Senate Finance Committee	04/29/13

BILL NUMBER PRINTER'S NUMBER (PRIME SPONSOR)	SYNOPSIS	CONCISE STATUS & HISTORY	DATE
	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.		
S. B. 917 P. N. 1031 (Argall)	PSERS and SERS, authorizing certain annuitant associations to obtain annuitant data from the system for the purpose of promoting membership in the annuitant associations.	Introduced and referred to Senate Finance Committee	05/06/13
S. B. 922 P. N. 1252 (Brubaker)	PSERS and SERS, amending the Codes of both Systems to: 1) Effective July 1, 2015, establish a defined contribution retirement benefit plan under a new chapter of the PSERS Code, Chapter 84, called the School Employees' Defined Contribution (DC) Plan. All new school employees or employees returning after a break in service would become participants in the new plan. Membership in the PSERS' defined benefit retirement plan would be closed to all new or returning employees. School employees participating in the DC plan would contribute 7.5% of compensation with an employer contribution of 4% of compensation; 2) Effective January 1, 2015, establish a defined contribution retirement benefit plan under a new chapter of the SERS Code, Chapter 54, called the State Employees' Defined Contribution (DC) Plan. Most new State employees or employees returning after a break in service will become participants in the new plan. Membership in the SERS' defined benefit retirement plan would be closed to all new or returning employees, except for Pennsylvania State Police Officers and correction officers. Most State employees participating in the DC plan would contribute 6.25% of pay with an employer contribution of 4% of compensation. For hazardous duty employees (including Capitol police and park rangers), the employer contribution rate would be 5.5% of compensation; and 3) Require all members of the General Assembly, members of the Judiciary, the Governor, the Lieutenant Governor, the Attorney General, the Auditor General and the Treasurer, who are current active members of SERS and are re-elected or retained after the effective date of the bill as amended to become mandatory participants in the State Employees' DC Plan.	Introduced and referred to Senate Finance Committee Reported as amended First Consideration Second Consideration Re-referred to Senate Appropriations Committee **Actuarial Note (A. 02498)**	05/15/13 06/19/13 06/19/13 06/20/13 06/20/13 06/26/13

APPENDIX E

CONCISE INDEX TO ACTUARIAL NOTES