SENATE APPROPRIATIONS COMMITTEE FISCAL NOTE

BILL NO. Senate Bill 1

PRINTER NO. 902

AMOUNT

See Fiscal Impact

FUND

School Employees' Retirement Fund
State Employees' Retirement Funds

DATE INTRODUCED

May 18, 2017

PRIME SPONSOR

Senator Corman

DESCRIPTION

Senate Bill 1 amends Title 24 (Education) relating to the Public School Employees' Retirement Code and Title 71 (State Government) relating to the State Employees' Retirement Code. The changes are as follows:

New Retirement Benefit Plan Options

Provides new members of the State Employees' Retirement System (SERS) and the Public School Employees' Retirement System (PSERS) with the option to elect one of three retirement benefit options, either one of two side-by-side hybrid defined benefit (DB)/defined contribution (DC) plans or a stand-alone DC plan. Allows current SERS and PSERS members, including elected officials, to opt into one of the new plans within 90 days from effective date of the respective plan. The new retirement plans become effective for SERS members January 1, 2019 and for PSERS members July 1, 2019. The plans are as follows:

- Option 1 - Side-by-Side DB/DC Hybrid (SERS Class A-5 and PSERS Class T-G)
  - If a member fails to elect one of the three plan options, the member is placed is this plan.
  - The DB plan multiplier is 1.25%.
  - Employees contribute 8.25% of compensation split between the DB and DC components as follows:
    - SERS employees, 5% DB component and 3.25% DC component.
    - PSERS employees, 5.5% DB component and 2.75% DC component.
  - Provides for the employer contribution to be actuarially determined for the DB component and 2.25% of compensation for the DC component.
  - Provides for "shared-risk" and "shared-gain" provisions to be calculated every 3 years comparing the actual and assumed rate of return for the past 10 years. For every percentage point in earnings realized in excess of or below the assumed rate of return, the employee contribution requirement will be increased or reduced by 0.75%, but no more than 3% above or below the initial contribution rate.

- Members would have an individual retirement account for the DC in which employee and employer contributions accumulate, and investment earnings and fees are credited and charged.
- The final average salary calculation is based on the 5 highest years and limits SERS voluntary overtime to 10% of base salary.
- Provides for 10-year vesting in the DB component.
- DC component employer contributions vest in 3 years, and employee contributions and related investment earnings vest immediately.
- Superannuation is age 67 with 3 years of service or "the rule of 97." The "rule of 97" is calculated by adding the member's age and number of years of service.
- Provides for an actuarially neutral Option 4 "lump sum" withdrawal of contributions.
- Provides reduced benefits for early retirement.
- Allows voluntary DC contributions.

- <u>Option 2 - Side-by-Side DB/DC Hybrid (SERS Class A-6 and PSERS Class T-H)</u>
    - The DB plan multiplier is 1%.
    - Employees contribute 7.5% of compensation split between the DB and DC components as follows:
        - SERS employees, 4% DB component and 3.5% DC component.
        - PSERS employees, 4.5% DB component and 3% DC component.
    - Provides for the employer contribution to be actuarially determined for the DB component and 2% of compensation for the DC component.
    - Provides for "shared-risk" and "shared-gain" provisions to be calculated every 3 years comparing the actual and assumed rate of return for the past 10 years. For every percentage point in earnings realized in excess of or below the assumed rate of return, the employee contribution requirement will be increased or reduced by 0.75%, but no more than 3% above or below the initial contribution rate.
    - Members would have an individual retirement account for the DC in which employee and employer contributions accumulate, and investment earnings and fees are credited and charged.
    - The final average salary calculation is based on the 5 highest years and limits SERS voluntary overtime to 10% of base salary.
    - Provides for 10-year vesting in the DB component.
    - DC component employer contributions vest in 3 years, and employee contributions and related investment earnings vest immediately.
    - For SERS members, Superannuation is age 67 with 3 years of service or "the rule of 97."
    - For PSERS members, Superannuation is age 67 with three (3) years of service.

  - Provides for an actuarially neutral Option 4 “lump sum” withdrawal of contributions.
  - Provides reduced benefits for early retirement.
  - Allows voluntary DC contributions.

- Option 3 - Stand-alone DC Plan Only
  - This plan does not include a DB component and is similar to a 401(k).
  - Employees contribute 7.5% of compensation.
  - Provides for the employer contribution to be 3.5% for SERS members and 2% for PSERS members.
  - Members would have an individual retirement account in which employee and employer contributions accumulate, and investment earnings and fees are credited and charged.
  - Employer contributions vest in three (3) years, and employee contributions and related investment earnings vest immediately.
  - Allows voluntary contributions into the plan.

Hazardous Duty Employees

- Exempts hazardous duty employees from participation in the new retirement benefit plan provisions. Hazardous duty employees would continue to become members of the current SERS DB plan. Exempt hazardous duty employees include: (1) State Police; (2) enforcement officers; (3) wildlife conservation officers; (4) Delaware River Port Authority Police Officers; (5) park rangers; (6) capitol police officers; (7) campus police officers at state-owned universities, community colleges, or Pennsylvania State University; (8) police officers employed by Fort Indiantown Gap or other designated Commonwealth military instillations or facilities; and (9) corrections officers.
- Changes the final average salary calculation for hazardous duty employees hired after January 1, 2019 to limit voluntary overtime to 10% of base salary.

Post-Act 120 Member Benefit Changes

- Provides for “shared-gain” provisions which mirror the “shared-risk” provisions that apply to these members. For every percentage point in earnings realized in excess of the assumed rate of return, the employee contribution requirement will be reduced by 0.5%, but no more than 2% below the initial contribution rate.
- Provides for an actuarially neutral Option 4 “lump sum” withdrawal of contributions.

Other Provisions

- Maintains provisions allowing employees of the state-owned universities, Pennsylvania State University and the Department of Education to choose an alternative retirement plan (TIAA-CREF).
- Maintains the "footprint rule" whereby members who return to service are reenrolled in the class of service they belonged to prior to the enactment of the new retirement benefit plan options.
- Provides for a "plow-back" of savings to accelerate the funding of SERS. In any year when there is projected to be a savings as a result of the legislation, the amount of savings is to be assessed as a percentage of DB and DC compensation.
- Changes the actuarial cost method for determining SERS normal cost from a "new entrant" method to a "blended" traditional entry-age actual cost method. The new method bases the normal cost on the benefits and contributions for all covered employees from their date of entry.
- Establishes the Public Pension and Asset Investment Review Commission to study and make recommendations to the General Assembly and the Governor regarding investment performance and investment strategies.
- Provides that PSERS employers will be charged interest at the assumed rate of return for delinquent payments.
- Adds the Secretary of Banking and Securities to both the PSERS and SERS boards.
- Requires PSERS and SERS Board members to obtain 8 hours of relevant training annually.
- Provides for PSERS and SERS legal counsel to serve independently from the Governor's Chief Counsel, the General Assembly and the Attorney General.

FISCAL IMPACT:

Based on the provisions contained in the legislation, the Independent Fiscal Office (IFO), in its Actuarial Transmittal Note for Amendments 01354 and 01558 to Senate Bill 1, estimates that the impact of the amendments contained in Senate Bill 1 will result in a cumulative savings of $1.396 billion, $217 million for PSERS and $1.18 billion for SERS.

Transitioning a part of the Commonwealth's pension portfolio to a defined contribution plan through the side-by-side DB/DC hybrid plans and the stand-alone DC plan will mitigate significant future risk and result in savings.

Risk Transfer New Entrants

The IFO analysis estimates the future risk reduction related to new entrants for PSERS to be 53% and for SERS to be 58%. If a 1% reduction in the assumed rates of return were to result, the risk transfer contained in the legislation would save $6.5 billion through 2050.

Expanding the "shared-risk" and "shared-gain" provisions will also mitigate future risk and result in savings to the Commonwealth. The IFO analysis estimates that if "shared-risk" and "shared-gain" were implemented for half of the projection period due to a 1% reduction in the assumed rates of return for both PSERS and SERS, the percentage of risk reduction for PSERS would increase by an additional 11% to 64% and for SERS would increase by an additional 8% to 66% and result in additional savings.

Analysis of the payroll data reveals that one increment of the "shared-risk" and "shared-gain" contributions applied to every fiscal year in which the provisions applies, would change new employee contributions by $2.4 billion for PSERS and $1.3 billion for SERS.

If one "shared-risk" and "shared-gain" increment is implemented after the first look-back and an additional increment is added every three years up to the maximum (3%), it would change the new employee contributions by $9 billion for PSERS and $4.8 billion for SERS.

Full-Risk Transfer Value
It is estimated that if a 1% reduction in the assumed rates of return were to occur under the current PSERS and SERS plans, employer contributions would increase by $49 billion. Assuming the full-risk transfer value of the new plans, when all employees have transitioned, the savings resulting from the legislation are estimated to be $26.9 billion, $15.5 billion for PSERS and $11.4 billion for SERS.

The provisions related to the Public Pension and Asset Investment Review Commission will result in a reduction in investment expenses paid by both PSERS and SERS as both PSERS and SERS are directed to target investment fee and cost savings strategies that can produce a total of $3 billion in savings.

Language is included in the legislation providing for the Commonwealth to make annual appropriations to PSERS and SERS for transition costs related to the implementation of the new pension plans and changes in the existing plans.