SB 1 (PN 902)

UPDATED JUNE 7, 2017

Overview of Proposal:

- **Effective 2019:** January 1 for SERS and July 1 for PSERS.
- **New Plan Design:** The complex plan design offers future (new) hires, or current employees who would like to opt-in, the option of three (3), newly established retirement plans, which include:
    - **Default Hybrid:** Defined Benefit & Defined Contribution plan with a 1.25 percent accrual rate and an employer contribution to the DC component of 2.25 percent.
    - **Alternative Hybrid:** Defined Benefit & Defined Contribution plan with a 1 percent accrual rate and an employer contribution to the DC component of 2 percent.
    - **Pure Defined Contribution (DC):** a 401k-style defined contribution plan with an employer contribution of 3.5 percent for SERS and 2 percent for PSERS.
    - Other plan provisions and details can be found in Table A and Table B, below.
- **Opt-in Provision:** Employees currently in the extant system will have an irrevocable choice to opt in to one of the three new plan designs.
- **Exemptions:** State Police, Corrections Officers and other hazardous duty personnel are exempted from participating in the new hybrid plan (approx. 30 percent of SERS active membership); however, the amount of voluntary overtime that may be included in the benefit is limited to 10 percent of salary or wages earned.
    - Note that State Police Troopers do not participate in Social Security, however Corrections Officers do.
    - PSP members who accrue 20 or more years of service will still qualify for the DiLauro award.
    - Future judges would be in the plan, however it would be expected that this aspect of the proposal could be challenged in court as an infringement of a unified judicial system.

Key Takeaways:

- **Unfunded Liability:** The proposal will pay down the Unfunded Liability at the same rate as Act 120. A new cost accounting methodology is applied reducing SERS' UL by approximately $4 billion. The cost is not lost, the employer contribution (in dollars) is commensurately increased in the near term as an offset.
- **Risk Transfer:** The IFO did not complete a stochastic analysis as recommended by their actuary. The IFO internally calculated estimates based on its own assumptions, and not assumptions adopted by the systems' boards & fiduciary actuaries. This violates a long held fiduciarily responsible practice of utilizing only certified actuarial analyses.
- **Long-Term Savings:** All savings are generated from cuts to benefits and are estimated to save $1.4 billion over 32 years on a cash flow basis. Savings are largely generated 20 years from now, when the unfunded liability is largely paid off. In today's dollars (present value) the plan will **cost** $57 million over this same time period.
- **Short-Term Costs:** Over the next 10 years, the proposal will **cost** $536 million more than under current law. Of this amount, $401 million is borne by the state ($247 million General Fund, $85 million special funds, $69 million other), $66 million federal funds and $69 million from school districts. These figures do not include implementation costs.
- **Implementation Costs:** The proposal will have up-front agency costs of roughly $25.6 million ($13.4 million PSERS and $12.2 million for SERS) in the first year, and second year costs of $17.2 million ($10.1 million PSERS and $7.1 million SERS). Funding for implementation is neither identified nor provided for in the bill.
- **Employee Contributions Increased, Benefits Reduced:** Employee contributions will in most cases increase between 10 to 32 percent, but can in some instances remain level. Compared to the current benefit provided for pursuant to Act 120, the proposal reduces benefits for future employees by roughly 13 to 35 percent depending on which of the hybrid options are selected and by 50 to 57 percent if the DC option is selected.

Impact to Employee Compared to Act 120	Default Hybrid		Alternative Hybrid		401k-style DC	
	SERS	PSERS	SERS	PSERS	SERS	PSERS
Contribution Increase	32%	10%	20%	0%	20%	0%
Benefit Reduction	(13%)	(17%)	(25%)	(35%)	(50%)	(57%)

- **Constitutional Implications:** The proposal permits current, post-Act 120 members to receive an actuarially neutral Option 4 benefit as well as participate in the shared-gain risk provision. Because these benefits are an improvement upon the current benefit, contract impairment issues are unlikely to be a major issue.
- **School District Impact:** It is expected that each school district will incur up-front costs to implement the changes. In addition, school district contributions are projected to increase roughly $69 million over the first 10 years after implementation.

Plan Details – Table A:

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Retirement Age, Normal	Both Systems: ▪ Age 67 with 3 years of service; or ▪ "Rule of 97". An employee must have at least 35 years of service and reach an age that in combination is equal to or greater than 97.
Retirement Age, Early	SERS: For the Default Hybrid, Age 57 with 25 years of service. For the Alternative Hybrid, Age 62 with 25 years of service. PSERS: For both the Default and Alternative Hybrids, Age 57 with 25 years of service. Both Systems: The benefit reduction is 3 percent for each year from age 57 to age 67 for SERS members and age 55 to 67 for PSERS members.
Age 62 Provision	Requires that unless a member qualifies to retire under Normal Retirement provisions (above), the member is may receive a cost-neutral annuity the defined benefit component of their benefit before reaching age 62 and 25 years of service. The discount rate applied is 4 percent for ages 62 to 67 and 7.325 percent before age 62.
Vesting	Defined Benefit Component: 10 years (same as Act 120). Defined Contribution Component: 3 years "cliff vesting" for the employer contributions and immediately for employee contributions.
Option 4 Lump Sum	If participants in the hybrid plans withdraw contributions, the benefit offered will be actuarially neutral. This option will be made available to current post-Act 120 members.
Final Average Salary	Calculated using the five highest years of salary including overtime, increased from the current three years final average salary calculation. Volunteer overtime compensation for new hires is capped at 10 percent of salary and/or wages when calculating the member's annuity.
Optional DC Annuity	System boards are required to make available an option for an annuity with a minimum interest rate of 2.5 percent.
Disability & Death Benefits	Eligibility and benefits would generally be consistent with Act 120 provisions applicable to members of the same class and category.
Implementation Funding	Systems will incur costs for the implementation of the new pension plans and to accommodate changes to the existing DB pension plan. Costs related to developing IT systems necessary for the new pension plan design, additional legal counsel and consulting services.
Shared-Risk / Shared-Gain	In the event of under investment performance, employee contributions are increased by a maximum of 3 percent; conversely, in the event of over investment performance, provides that employee contributions are decreased by no more than 3 percent. The annual adjustment will be an increase or decrease of 0.75 percent.
Employer Full ARC Payment Requirement	In the event the employer does not make its full actuarially required contribution (ARC), the member contribution shall not be increased for membership classes affected by the shared risk or gain provision.
Footprint Rule	If there is a break in service, current members would retain their pre-reform benefit.
Independent Legal Counsel	Permits the legal counsel to the systems' boards shall serve independently from the Governor's Office of General Counsel, the Attorney General and the General Assembly.
Board Composition	Systems boards are required to include the Secretary of Banking and Securities, replacing one of the Governor's current appointees.
Board Education	Systems board members are required to receive 8 hours of relevant financial training.
Newly Created Commission	Establishes the Public Pension Management and Asset Investment Review Commission composed of five members appointed by: the Senate President, House Speaker, Senate Minority Leader, House Minority Leader, and Governor.
Investment Efficiencies	Charges the newly created commission to identify and make recommendations to reduce expenditures, both PSERS & SERS, to generate actuarial savings of $1.5 billion over 30 years.
Investment Restrictions	The provisions in the bill to provide a minimum of 10 investment options offered by three or more providers.
DC Plan for School Employees	Establishes parameters for school district administration of a 403(b) defined compensation plan and may participate in the DC plan established by PSERS.
Higher Education	May continue to offer TIAA-CREF as an option to its employees.

Plan Details – Table B:

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Plan Option	Current		Proposal					
	Defined Benefit		Default 1.25% Hybrid (DB|DC)		Alternative 1% Hybrid (DB|DC)		401k-style DC Plan	
System	SERS	PSERS	SERS	PSERS	SERS	PSERS	SERS	PSERS
Exemptions	None.		SERS only: State Police, Corrections Officers, enforcement officers, DRPA, Game Comm. Officers, Park Rangers, Capitol & Campus police					
Final Average Salary	--- 3 highest years ---		----------------- 5 highest years -----------------				-------- n/a --------	
Vesting								
Defined Benefit	----- 10 years -----		---------------------- 10 years ----------------------				-------- n/a --------	
Defined Contribution								
Employer	-------- n/a --------		------------------------------ 3 years, Cliff Vesting ------------------------------					
Employee	-------- n/a --------		------------------------------- Immediate Vesting -------------------------------					
Plan Components								
Defined Benefit								
Accrual Rate	*2.00%*	*2.00%*	*1.25%*	*1.25%*	*1.00%*	*1.00%*		
Employer Normal Cost	4.52%	2.97%	2.01%	0.45%	1.67%	0.35%		
Employee	6.25%	7.50%	5.00%	5.50%	4.00%	4.50%		
Total -- Defined Benefit	10.77%	10.47%	7.01%	5.95%	5.67%	4.85%		
Defined Contribution								
Employer			2.25%	2.25%	2.00%	2.00%	3.50%	2.00%
Employee			3.25%	2.75%	3.50%	3.00%	7.50%	7.50%
Total -- Defined Contrib.			5.50%	5.00%	5.50%	5.00%	11.00%	9.50%
Total								
Employer	4.52%	2.97%	4.26%	2.70%	3.67%	2.35%	3.50%	2.00%
Employee	6.25%	7.50%	8.25%	8.25%	7.50%	7.50%	7.50%	7.50%
Grand Total	10.77%	10.47%	12.51%	10.95%	11.17%	9.85%	11.00%	9.50%
Employee Cost vs. Act 120			*32%*	*10%*	*20%*	*0%*	*20%*	*0%*
Employer Cost vs. Act 120			*(6%)*	*(9%)*	*(19%)*	*(21%)*	*(23%)*	*(33%)*
Benefit Estimates								
Benefit as % of Act 120			87%	83%	75%	65%	50%	43%
Replacement Income	68%	68%	59%	56%	51%	44%	34%	29%
Retirement Requirements								
Normal	Age 65 w/ 3 years		---------------- Age 67 with 3 years ----------------				n/a	n/a
	Rule of 92 w/ 35 years		------------- Rule of 97 with 35 years -------------				n/a	n/a
Special Early Retirement	n/a	55/25	----- 57/25 -----		62/25	55/25	n/a	n/a
Estimated Cost/(Savings), $million			SERS	PSERS	Total			
32-Year Cash Flow			($1,180)	($217)	($1,396)			
32-Year Present Value, 7.5%			$9	$48	$57			
First 10 Years, cash flow			$385	$151	$536			
New Proposal Option Selection (% of employees)								
SERS	*as estimated by each*		50%		25%		25%	
PSERS	*systems' actuaries*			65%		30%		5%

Useful Performance Metrics to Assess the Impact of the Proposal vs. Status Quo

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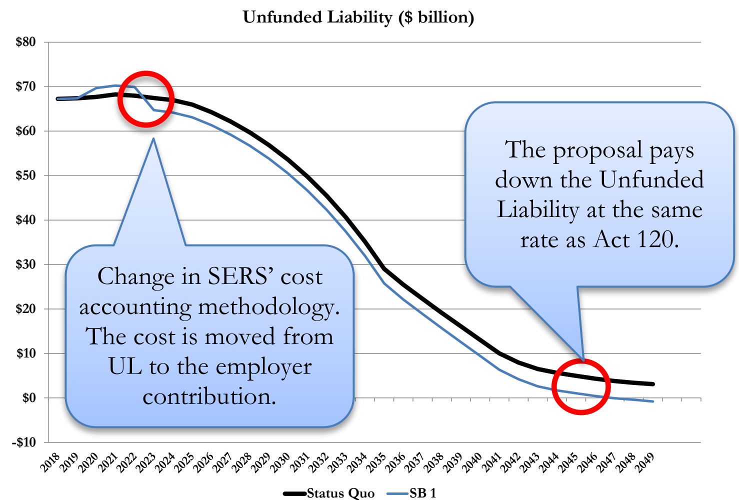
Performance Metric | Chart

An **Unfunded Liability** exists when liabilities are greater than assets.

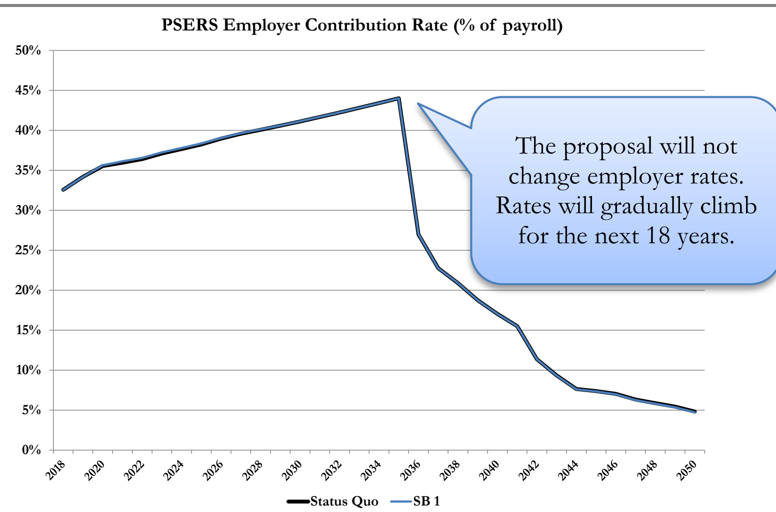
For both systems, in FY 2017/18, 78 percent, or $4.9 billion, of the $6.2 billion employer payment will be used to pay down the pension debt.

Note that in year 4 (2022), an adjustment in the UL is observed. This occurs only within the SERS system and is attributable to a cost accounting methodology, <u>not</u> from the benefit plan design.



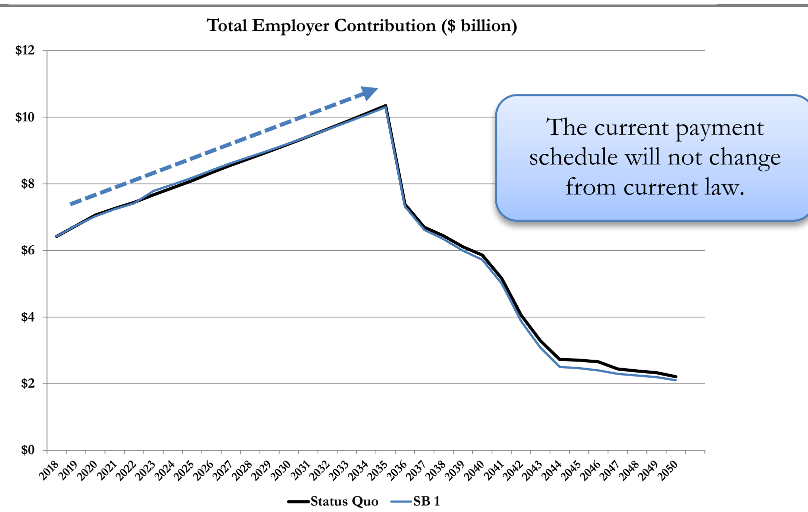
The **employer contribution rate** is calculated by actuaries and includes the cost of the benefit plus the cost of the unfunded liability.

School districts' employer contribution rates are expected to gradually climb over the next 18 years to 44 percent of payroll, then rapidly declines when the debt (principal and interest) is largely amortized.



The **total employer payment** is the projected dollar amount that employers must pay per year.

In either case, going with the status quo or with a stacked hybrid plan, the total pension payment made by all employers will increase for the next 18 years from $6.4 billion (2018) to about $10.4 billion (2035). For the next 22 years, employers will pay more than they pay today - in terms of dollars spent.



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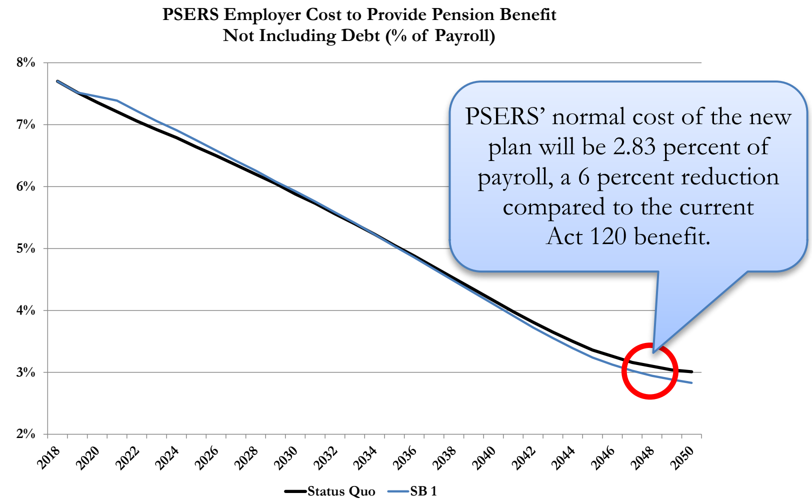
Performance Metric	Chart

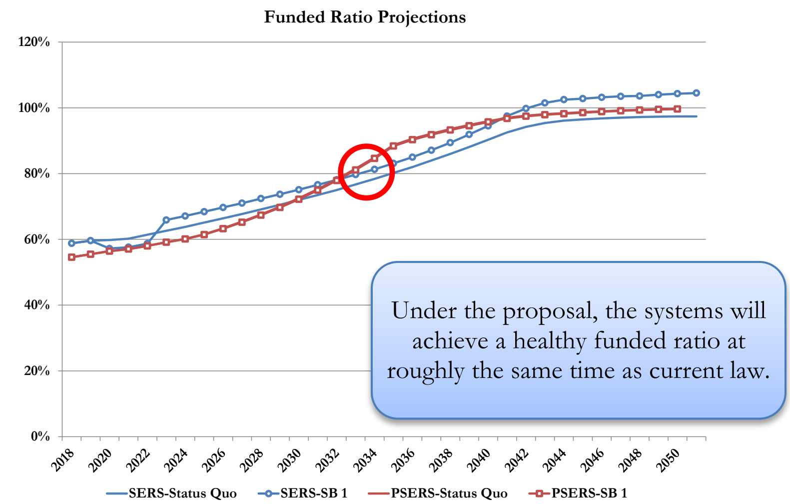
The **employer cost** to provide pension benefits is calculated by actuaries and is the cost today to provide an earned pension benefit in the future. Also called the "employer normal cost".

Currently the cost for PSERS' employers and the school districts to provide a pension benefit for its employees (i.e. the normal cost), is approximately 3 percent (3.01 percent). The proposed hybrid plan cost to provide a benefit will be 2.83 percent, which is a cost reduction of 6 percent.



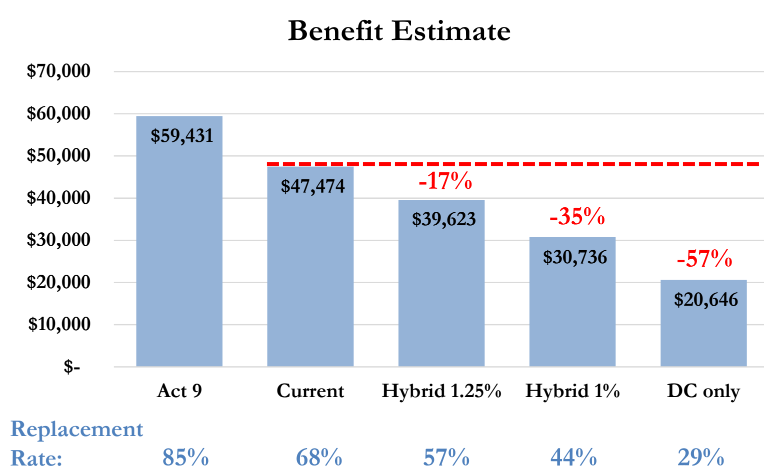
Expressed as a percentage of a system's liabilities, the **funded ratio** is calculated by dividing assets by its liabilities. A ratio above 80 percent is considered "healthy" for state government pension plans which operate in perpetuity. Compared to private companies (which can be dissolved at any time) that have pension plans, ERISA requires any shortfall be paid off in 7 years.

As is shown in the chart to the right, both systems will achieve an 80 percent funded ratio at the same time with or without the proposal.



The **estimated benefit** provides a calculated estimate of what a typical employee benefit will be under the proposal relative to a comparable benefit being currently earned.

The **replacement rate** is a term that is used to provide a number to help individuals plan for retirement and is expressed as a percentage that is calculated by dividing the estimated pension benefit by their pre-retirement income. A target replacement rate is roughly between 75-80 percent. The replacement rates shown do not include Social Security.



Example: PSERS member with 35 years of service and a final average salary of $70,000.