

Memo: Pension Legislation

From: Senators Corman, Browne, Scarnati, Gordner, Eichelberger

This week, we plan to introduce **Senate Bill 1**, comprehensive legislation designed to modernize the Commonwealth's retirement systems in order to bring significant updates to the funding, sustainability and fiscal responsibility of the two main pension funds.

The pension reform debate is not new to Pennsylvania and has been discussed, researched and debated through many hearings in both Chambers of the General Assembly over the last two years. Through these hearings and extensive research, we have developed a plan that will move the Commonwealth to a more stable future with regard to statewide pensions.

Senate Bill 1 is a historic plan that reflects the seriousness of the situation the Commonwealth faces with pensions. It's a problem that demands aggressive actions. Restructuring the public pension system in this manner will provide tangible, structural improvements for current and future employees. **This proposal does not reduce in any manner and makes no changes whatsoever to benefits already earned by existing employees or retirees.**

The amount of money needed to meet the public pension obligations in its current form is unsustainable. This year alone, we face a \$1 billion increase in our pension obligations. The current growth of the system is beyond our means. **Senate Bill 1** takes the investment risks off the taxpayers with regard to pensions while shielding the retirement security of public employees from political risk.

The time is now to move forward with a broad plan to address the current pension emergency that has severely impacted the Commonwealth with regards to funding education, as well as all other appropriations. Once we restructure the system, state government will find itself in a better position to fund vital programs without looking to massive tax increases. School districts will find themselves with more money to direct toward educating students, instead of grappling with property tax increases.

Senate Bill 1 seeks to impact future costs and sustainability through the following:

- **New Member Benefits**
 - **Defined Contribution for new employees:** All new state and public school employees will be enrolled in a mandatory Defined Contribution Plan.
 - **Employers will be required to contribute the amount equal to the current DB normal cost of post Act 120 employees.**
 - **For State Police, the employer contribution rate is 12.2%.**
 - **Mandatory Retirement Security Plan:** New employees will be required to contribute up to 3% of payroll into a cash balance plan. Employees will earn interest at the long term treasury rate capped at 4%.

- **Members of the General Assembly, upon election and/or reelection, will be enrolled in the Defined Contribution Plan. The Defined Contribution plan provision will be consistent with state and public school employees.**
- **Current Member Benefits**
 - **For all future earnings, contributions will be increased by 3% for PSERS and 2.5% for SERS to maintain Act 9 benefit levels. If the employee chooses not to increase their contribution to this level, the employee's prospective benefit rolls back to pre-Act 9 levels (2.0 multiplier and contribution of 6.25% for PSERS and 2.0 multiplier and contribution level of 5.0% for SERS).**
 - **Anti-spiking Provision: Compensation for extra duty service included in each of the three highest years cannot exceed the average for the last five years of service. This provision currently applies to all post-Act 120 employees.**
 - **Prospective Revenue-neutral Option 4: provides all future member contributions will be accessible upon retirement at an actuarially neutral rate beginning January 1, 2016 for SERS employees and July 1, 2016 for PSERS employees.**
 - **Contribution Savings Provision: Every three years, the system will calculate the difference between actual and assumed returns. For every percentage that the system realized a return in excess of assumed returns during the calculation period, an employee's contribution, for those who chose the increased contribution option, will be reduced by ½ percentage point for the following three years. Those employees who did not choose the increased contribution level will not be eligible to have their employee contribution rate reduced.**
 - **Optional Retirement Security Plan: employees will be eligible to contribute up to 3% of payroll into an optional cash balance plan.**
- **Additional Provisions:**
 - **Public Pension Management and Asset Investment Review Commission: A commission of investment professionals and retirement advisors will be established to study, publish findings and make recommendations to the General Assembly and the Governor as to:**
 - **The performance of current investment strategies and procedures of both state retirement systems as to realized rates of return against established benchmarks and associated fees paid for active and passive management**
 - **The costs and benefits of active vs passive investment strategies in relation to future investment activities of both state retirement systems.**
 - **Alternative future investment strategies of both state retirement systems which will maximize future realized net of fees rates of returns with available assets**
 - **Extensive, detailed on-line publication of information about assets, returns, financial managers, all consultants, RFPs, and investment performance measured against benchmarks.**
 - **The commission will include 3 members appointed by the Speaker of the House, the President Pro Tempore of the Senate and the Governor.**

- The commission will submit its recommendations to the Governor and the General Assembly within 6 months of its first organizational meeting
- Funding Protection Mandate: Each member of PSERS and SERS, after the current employer compensation schedule meets the full actuarial amount, will have a contractual right to the annual required contribution made by the employer or by any other public entity.
- Board membership/ qualifications:
 - Membership: Both PSERS and SERS Board complement will be amended to add the Secretary of Banking and Securities.
 - Training: Each member of the PSERS and SERS Board will be required to obtain 8 hours of mandatory training in investment strategies, actuarial cost analysis and retirement portfolio management on an annual basis.
 - Independent Counsel: Legal counsel to both PSERS and SERS will serve independently from both the Governor's Office of Chief Counsel, the General Assembly and the Attorney General.

Senate Pension Plan Outline

Senate Bill 1

Main Components

- Current Employee Changes (Pre Act 120 – Act 120 employees will have minor changes)
 - Multiplier
 - Member contribution rate WILL INCREASE as of January 1, 2016 (SERS)/July 1, 2016 (PSERS) from the current 6.25%/7.50% of compensation to 8.75%/10.3% of compensation. Their annual benefit accrual rate will remain at 2.5% of final average salary for each year of future service credit. This is the default. OR
 - Members will have the opportunity to elect to contribute at 5%/6.25% of compensation to have an annual benefit accrual rate of 2% of final average salary for future years (Pre Act 9 accrual rate and contribution).
 - Applies to all employees regardless of their position: General Assembly, elected officers, prison guards, other public safety officers, rank and file state employees and public school employees. However, this DOES NOT apply to State Police of the Judiciary, as they were not impacted by the Act 9 changes.
 - Actuarially Neutral (tied to the assumed rate of return) lump sum Option 4 withdrawal applied to member contribution rates after the effective date of the act. Example: 20 year past service employee with 15 future years can take the option 4 withdrawal at 4% for past 20 years and at 7.5% for last 15 years.
 - Risk share
 - 3 year averages to determine an increase or decrease employee contribution up to 1 point

- Optional Cash Balance Contribution: current employees will be eligible to contribute up to 3% of payroll into an optional cash balance plan. The employer will not match these contributions and the contributions will be comingled with the assets of both systems. Employees will earn interest credits on their contribution at the long term treasury rate capped at 3%. Upon retirement, the employee is eligible to receive their contribution and interest credits in a lump sum or a life time annuity. (Will also apply to post Act 120 employees).
- Anti-spiking provision: Compensation moving forward for extra duty service included in each of the three highest years cannot exceed the average for the last five years of service.
- New Define Contribution system for new employees
 - DC for new state employees, public school employees, and legislators
 - Includes the State Police and Corrections
 - Not the judiciary
 - Tied to normal cost (3 for PSERS/ 5 for SERS)
 - Mandatory Cash Balance Contribution: current employees will be eligible to contribute up to 3% of payroll into an optional cash balance plan. The employer will not match these contributions and the contributions will be comingled with the assets of both systems. Employees will earn interest credits on their contribution at the long term treasury rate capped at 3%. Upon retirement, the employee is eligible to receive their contribution and interest credits in a lump sum or a life time annuity. (Will also apply to post Act 120 employees).
- Mandatory Defined Contribution Plan for members of the General Assembly: All new members and existing members upon reelection will be enrolled in the Defined Contribution Plan consistent with those applicable to state and school employees.

Secondary Components

- Lump sum withdrawal – designed to reduce liabilities: Retiring employees and current annuitants will have the option of receiving a lump sum of the present value of their accrued benefit. Both systems will establish process and procedures to determine the participant's eligibility to qualify for the lump sum. To ensure "adequate" retirement security, process and procedures will consider additional cash flow and liquid assets available to the applicant (i.e. will not let someone make a terrible decision).
 - This appeals to those looking for anyway to impact the unfunded liability.
- Public pension management and assets investment review commission. A commission of investment professionals and retirement advisors will be established to study, publish findings and make recommendations to the General Assembly and the Governor as to the performance of current investment strategies, the cost and benefits of active vs. passive investments strategies, et al. the commission will include 9 members (3 members each) appointed by the Pres. Pro Temp, Speaker and Governor.
 - Designed to target investment argument (Rafferty and Wagner).
- Salary cost control protection: for school districts fiscal years beginning after the effective date of this act, the incremental increase in state general fund contribution to the school employee's retirement plan will not include increases in covered payroll per member from the prior fiscal year ABOVE THE ANNUAL INCREASE IN THE STATEWIDE WEEKLY WAGE.
 - Appeals to property tax argument.
- Funding protection mandate: Each member of the PSERS and SERS, AFTER THE CURRENT EMPLOYER COMPENSATION SCHEDULE MEETS THE FULL ACTUARIAL AMOUNT, will have a contractual right to annual required contribution made by the employer or by any other public entity. The failure of the state or any other public employer to make

the annually required contribution will be deemed to be an impairment of the contractual rights of each employee.

- Appeals to the underfunding argument.
- Board changes (who can chair, independent council)