Public Employee Retirement Commission

June 25, 2013

The Public Employee Retirement Commission met to hold a regular meeting and consider three actuarial notes.

Executive Director James McAneny reviewed the three actuarial notes for the meeting. Moving to Act 205 reports, he said for the 2013 filing period, forms have been sent 4,596 municipalities as of April 1, 2013. As of June 17, he reported, there have been 3,069 received and processed. The commission has received 171 actuarial reports based upon that questionnaire with 3,200 actuarial valuation reports anticipated to be processed by the commission by the end of the applicable period. He said six actuarial notes have been attached to bills or amendments with 56 pension related bills or resolutions being tracked by the commission, 12 of which have seen legislative movement.

The commission then moved to legislative review.

HB 1352 Kampf, Warren - (PN 1846) Amends Titles 24 (Education) and 51 (Military Affairs), in preliminary provisions, further providing for definitions and retirement membership. The legislation provides incentives for early retirement and revises the law regarding pensions for school district employees under Public School Employees Retirement System (PSERS), substantially revising the pension system and providing for a defined contribution program. - The commissioners unanimously **attached the actuarial note as amended** by the discussion.

McAneny described the both House Bills and the amendments adopted at this morning's House State Government Committee meeting. Regarding actuarial costs for both bills, it was noted the work of the commission's actuary believes it is reasonable that long-term investment return will be lower under a closed plan. He said the actuary finds the move to a defined contribution plan moves a portion of the benefit financing and will it take a significant period of time before the transfer sees risk reduction, meaning there will be a long period of time before savings are seen in terms of contributions. McAneny noted GASB requirements say when a plan is closed the amortization period must be tied to the active working life of employees and said there will be a significantly smaller period of time in which the active work life will decrease, allowing the obligation to be paid off quicker. He stated the earnings rate of seven percent is not sustainable.

Chairman Anthony Salomone asked if the actuary is saying there are cash flow issues forcing managers to become more risk adverse. McAneny said that is true and noted part of that is the need to pay benefits immediately rather than put the money into long term investments producing more income that would support a higher earnings assumption. McAneny noted the funds are in a negative cash flow with the actuary believing the need for available assets will compel a reduction. He stated this does not mean the commission's actuary has not accepted the numbers provided by anyone. He said the commission's actuary is not agreeing with anyone's actuarial analysis, particularly Milliman's.

Chairman Salomone asked if multiple actuaries would agree with the cost savings numbers provided in the charts in the actuarial notes and the cost for closing the system. McAneny pointed to Table 1 and said the numbers he has seen from the different actuaries has the primary disagreement centered around the implications surrounding the closing of the defined benefit program because of the issues relating to the pressure on future earnings.

McAneny said, looking at the Public School Employees Retirement System's (PSERS) actuary, the decrease in the amortization period will have a statutory cost. He said benefit reforms of defined contribution plans moving forward will also have a cost. McAneny noted savings in premium assistance of $2.7 billion and a cost-neutral savings of $2.6 billion and the average salary change creating more than $3 billion in savings. He said there will be a $35 million cost in financing reforms. McAneny noted savings and costs located in the actuarial note for House Bill 1353 from Buck actuaries located in the actuarial note regarding the changes to the State Employees Retirement System (SERS).

The following policy considerations were given for House Bill 1352:

- Potential contract impairment: Active member benefit modifications in the proposed legislation could potentially be found to impair the rights of affected active members
- Benefit value and security: The defined contribution plan is likely to be less predictable and involve greater individual attention to risk than the typical defined benefit plan
- Delegation of Legislative Authority: The power given to the board to develop and implement the defined contribution plan may be held as an unlawful delegation of legislative authority in the area.
- Technical operational issues:The move to a defined contribution plan could lead to the following technical operational issues: closed group funding dynamics, loss of premium assistance, less risk sharing .

Rep. Warren Kampf (R-Chester) noted he does not have a retained actuary, but said the administration gave him the assistance of Milliman in crafting the legislation. He said by incorporating the costs of the actuaries from the change in the note makes the numbers on the cost of the legislation and asked for the Milliman numbers to be included in the numbers in the actuarial note. He stated when talking about this, the rate of return on a closed plan needs to be looked at and pointed out the commission adopted a similar plan that did not reduce the rate of return in the 30-year funding system. He said in adopting this note, the inconsistency in the action between then and now needs to be pointed out. Discussing the regulation health care for SERS, Rep. Kampf said this is a regulatory issue and not fit for legislation. He read from a letter sent to him from the Arnold Foundation casting doubt on some of the work done by the actuaries included in the notes. Chairman Salomone asked who the Arnold Foundation is. Rep. Kampf said it is a nonprofit think tank from Texas with an avenue of interest in public pensions.

David Draine of the Pew Charitable Trusts said if Pennsylvania does close its defined benefit plan, it will pay off the amount owed with the plan keeping investments in less risky assets years down the line after the pool of those remaining in the defined benefit plan drops under 25 percent. He said the plan should move to less risky investments in 2024. He said the public school plan has less of a concern regarding liquidity than the state employees system. He noted the states making the change to the defined contribution plan have not had to quickly find liquidity. Chairman Salomone asked if the fact that there is a negative cash flow in the plans now is in part why the system's actuaries were so conservative in their analysis. Draine said the cash flow problems in the future are not any greater than what the state is facing now. He said the actuaries are focusing on tying the closing of the plan to payroll, which he said is not tied to just those employed in a defined benefit plan. Chairman Salomone asked at what point Draine believes the discount rates should be lowered. Draine said when it gets 2:1 or 3:1, but said there is no evidence that needs to happen with things as they are now at 10:1. Rep. Kampf added being cash flow negative occurs in both circumstances for a period of time and said the liquidity analysis goes year-by-year with the dollars in the fund 30 years from now being the same as liabilities. He said this shows, over the life cycle, dollars will have to be put in to meet the needs of the system. He said the state is facing 32 percent employer rates in four years, with similar rates at SERS, to continue for 15 or 20 years.

Commissioner Carville Foster said listening to the figures of actuaries, there are substantial areas of agreement and consensus with the view expressed by Rep. Kampf being a differing opinion. He said all information should be made available so the information can be compared and contrasted. Rep. Kampf stated it is his view that there are a series of agreements and disagreements and argued it would be best to present all of them, especially if the positions of the commission's actuaries are adopted. He noted every decision made by lawmakers is done based upon judgment formed in part by the actuarial notes. Draine said the plans, when closed in 2015, will be functioning for 60 years and detailed the benefit of what will be paid out while the plan is still functioning.

Steve Nickol of the Pennsylvania State Education Association noted a history of pension underfunding and said the systems did not make as much as projected and are now starting to cost taxpayers. He said he was concerned about illusory projections of savings in moving to a defined contribution plan as put forth in proposed legislation in 2010. He explained the closure of the defined benefit plan would increase the higher actuarially accrued liabilities and raise the need for more liquid assets. He said the costs of transition from a defined benefit plan to a defined contribution plan cannot be ignored. He also said analyses done with regard to Senate Bill 566 in 2010 were done when the rate of return was assumed to be higher and was before Act 120 of 2010 was enacted. He argued that a closed pension fund assumes the life of a mortal human where it ages and gradually diminishes until it dies.

Moving to the deliberations of commission members, Chairman Salomone said the construction of the actuarial note needs to be reordered. McAneny suggested Tables 1 and 2 with accompanying notes and references be deleted from the body and moved into an appendix to include work by Milliman and have work submitted to the Office of the Budget be included in another appendix. Also, it was noted the communications form the Arnold Foundation and the Pew Charitable Trust be included in another appendix. Sen. Pat Browne (R-Lehigh) said if there is information from actuaries not in the tables that could defend positions, those opinions should be included as well along with any testimony provided on the matter.

Chairman Salomone said it should be made clear that the commission does have someone who is the commission's actuary and they should be clearly identified and have it emphasized where that actuary's work comments on the work of the other three actuaries. Sen. Browne said the thoughts of the other actuaries should be included as those of the commission's actuary. Chairman Salomone noted he wanted to include where the actuary opined on the outcomes and said the role of the commission is to provide the General Assembly the best possible information. Rep. Mike Tobash (R-Schuylkill) agreed all information from all actuaries should be included so members of the General Assembly can have all of the information where it is clear who made the information and how the analysis was developed. Commissioner Foster agreed the inclusion of as much information as possible is to everyone's advantage.

McAneny said the commission will be recessing until tomorrow afternoon and suggested staff work to make the changes to make everyone see tomorrow and have them adopted at that point. Chairman Salomone said it does not need to be put off until tomorrow since it is just the moving of text and the addition of information. He said this work should not delay House deliberations. Rep. Tobash said if the changes were made by tomorrow it would give the House enough time. Chairman Salomone said the commission does not want to get in the way of the deliberations of the House. McAneny said the commission should move the note as amended, but noted the commission will have the amended notes tomorrow for review. It was decided the commission would attached the actuarial notes to House Bill 1352 and 1353 as amended with the amended versions to be released at the next meeting of the commission.

HB 1353 Kampf, Warren - (PN 1847) Amends Title 51 (Military Affairs) and Title 71 (State Government) in Title 51, in employment preferences and pensions, to provide for leaves of absence without pay and further provide for definitions. Amends Title 71, in retirement for state employees and officers, to make editorial changes and substantially alter and revise the law regarding state pensions providing for a defined contribution program for state employees. - The commissioners unanimously **attached the actuarial note as amended** by the discussion.

The following policy considerations were given:

- Potential contract impairment: Active member benefit modifications in the proposed legislation could potentially be found to impair the rights of affected active members
- Benefit value and security: The defined contribution plan is likely to be less predictable and involve greater individual attention to risk than the typical defined benefit plan

• Delegation of Legislative Authority: The power given to the board to develop and implement the defined contribution plan may be held as an unlawful delegation of legislative authority in the area.
• Technical operational issues: The move to a defined contribution plan could lead to the following technical operational issues: closed group funding dynamics, less risk sharing, and uncertainty surrounding how the Retired Employee Health Program.

SB 922 Brubaker, Michael - (PN 1252) Amends Titles 24 (Education), 51 (Military Affairs) and 71 (State Government) extensively revising pension provisions: for the Public School Employees' Retirement System, in the areas of preliminary provisions, of membership, contributions and benefits, of School Employees' Defined Contribution Plan, of administration and miscellaneous provisions and of health insurance for retired school employees; for military pensions, in the area of military leave of absence; for the State Employees' Retirement System, in the areas of preliminary provisions, of membership, credited service, classes of service and eligibility for benefits, of School Employees' Defined Contribution Plan and of contributions, of benefits, administration, funds, accounts, general provisions; and providing, as to the revisions, for construction, applicability, funding, amortization, re-amortization, recertification, liability and legal challenge. (Prior Printer Number: 1079) - The bill was **passed over**.

McAneny noted the commission did not receive the actuarial work from SERS until 8:00 p.m. last night with the actuary continuing to work on the legislation's actuarial note. McAneny recommended recessing until 3:00 p.m. tomorrow at which time the actuarial note will be considered and attached.