

**PUBLIC EMPLOYEE RETIREMENT COMMISSION****ACTUARIAL NOTE TRANSMITTAL**

Bill ID: Senate Bill Number 566, Printer's Number 577,  
as amended by Amendment Number 08034

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

Subject: Unified Contribution Pension Plan

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**SYNOPSIS**

Senate Bill Number 566, Printer's Number 577, as amended by Amendment Number 08034, 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 school and state employees hired after July 1, 2011. The new retirement system established by the bill as amended, known as the Public Employees' Retirement System (PERS), would be a defined contribution (DC) pension plan.

**DISCUSSION****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 PSERS and SERS is to provide retirement allowances and other benefits, including disability and death benefits to public school and state employees. As of June 30, 2009, there were approximately 754 participating employers, generally school districts, area vocational-technical schools, and intermediate units in PSERS, and as of July 2009, there were approximately 107 participating state and other organizations in SERS.

Membership in the retirement systems 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, 2009, there were 279,701 active members and 177,963 annuitant members of PSERS, and as of December 31, 2009, there were 110,107 active members and 109,639 annuitant members of SERS.

## **DISCUSSION (CONT'D)**

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 multiplied by the member's final average (highest three years) salary. Most members of PSERS are Class T-D members and contribute 7.5% of pay, while most members of SERS are Class AA members and contribute 6.25% of pay. Within both Systems, there are also a number of additional membership classes with corresponding benefit accrual and employee contribution rates that differ from the majority of school and state employees.

Under the Codes of both PSERS and SERS, 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 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 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.

### **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 PERS plan proposed in the bill as amended, 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

## **DISCUSSION (CONT'D)**

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 require 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 significantly as employees approach retirement age.

### **Public Employees' Retirement System (PERS)**

The bill as amended would establish a new mandatory retirement system applicable to all public employees hired by school or State employers within the Commonwealth after July 1, 2011. The new retirement system, known as the Public Employees' Retirement System (PERS), would replace the defined benefit plans provided by PSERS and SERS with a defined contribution retirement plan. Membership in both PSERS and SERS would be closed to new entrants effective July 1, 2011. Current members of PSERS and SERS would retain membership in those Systems.

If enacted, the bill as amended would create an entirely new public employee retirement system, eventually replacing both the traditional defined benefit plans currently provided by PSERS and SERS with a single defined contribution plan applicable to all school and state employees. The bill as amended requires the creation of a new governmental entity, which is a major undertaking, with all of the costs and complexities associated with the creation of any new governmental institution. The creation of this new, statewide public employee retirement

## **DISCUSSION (CONT'D)**

system, known as PERS, presents a range of fairly complex issues that require careful consideration. For the purposes of the Commission's discussion, the major issues 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 PERS, establishes the PERS Board, and sets forth the Board's composition, powers and duties, including staffing, contracting with vendors and funding of operations. Most of the details governing the actual operation of PERS are delegated to the PERS Board which will be responsible for establishing the rules and regulations governing the System. These rules and regulations will presumably address the many specific details involved in the operation of a public pension system, such as the collection of contributions, investment options, benefit payment methods, domestic relations orders, beneficiary designations, etc. It also appears that most of the new System's investment and administrative functions will be handled by third-party administrators contracted by the Board to provide the necessary services.

The bill as amended is unclear on how the administrative expenses of PERS are to be funded. Under section 7105(f), the PERS Board will be required to submit an annual budget to the General Assembly for the administrative expenses of the System. The approved expenses are to be paid "in whole or in part" from member "nonvested forfeitures" (a term which is not defined) in PERS, and reference is also made to the payment of directed commissions by the board. Section 7108 states that, "all other expenses arising from the administration of the system," are to be paid from the individual retirement accounts of active members of the System.

The creation of a large governmental institution such as PERS will be costly. Because PERS will initially have no assets and few members, it seems likely that the current funding process provided for in the bill as amended will prove insufficient, at least in the early years of operation. It appears likely that appropriations, either from the Commonwealth General Fund or some other source identified and authorized by the General Assembly, will be necessary to meet the initial and ongoing annual administrative funding requirements of PERS.

### ***Coverage, Benefits and Contributions***

Section 7101 sets forth the intent of the proposal in the bill as amended, which is to preserve the long-term fiscal stability of the Commonwealth and "school districts" by replacing the

## DISCUSSION (CONT'D)

defined benefit plans provided through PSERS and SERS, with a single, unified, tax-qualified, defined contribution retirement system for all employees of the Commonwealth and “school districts.” Although the bill as amended makes specific reference to the employees of school districts, section 7102 defines the terms “public employee,” “state employee,” “school employee,” and “public school” more broadly. Together, these new definitions function to encompass the employees and officials of nearly all school employers including state-owned educational institutions, community colleges and the Pennsylvania State University. Nearly all Commonwealth employers, including the General Assembly, the judiciary and many independent or quasi-independent governmental employers are included as well. Membership in PERS would be mandatory for all such employees newly entering service.

The treatment of former members of SERS and PSERS (vestees, inactive members and annuitants) who return to public service following a break in service is not clear. Section 7115(d) seems to indicate that membership in PERS would be mandatory only for those employees who enter into public service, “for the first time after July 1, 2011.” Likewise, section 7117(1) indicates that PERS membership would not be mandatory for any employee who is employed prior to July 1, 2011. However, section 7117(2) of the bill as amended contains the contradictory and confusing requirement that this chapter, “shall apply to any person who is a public school employee or state employee before July 1, 2011, and who is not a public employee on July 1, 2011, *but reenters public service after July 1, 2011.*”

There is also a conflict with respect to the effective dates applicable to mandatory membership in PERS. In section 7102 under the definition of “public employee,” membership in PERS would be mandatory *after November 30, 2011*. However, throughout the bill, an effective date beginning after July 1, 2011, is also used. For the purposes of the Commission’s discussion, it has been assumed that the November 30, 2011, date is a drafting oversight and that the date of *after July 1, 2011*, is the effective date intended by the sponsors of the proposal.

Clearly, by mandating participation in PERS for new hires only, it is the intent of the sponsors of the bill as amended to avoid impairing the retirement benefit rights of current PSERS & SERS members. It has been well-established that in the Commonwealth, 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). *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 unilaterally diminished or adversely affected, regardless of whether (1)

## DISCUSSION (CONT'D)

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).

The PERS plan is a defined contribution pension plan. The language in the bill as amended is unclear as to whether member contributions to the plan are mandatory or voluntary. Section 7111 seems to indicate that member contributions are mandatory by stating that "regular active member contributions shall be made to the System on behalf of each active member," and that the employer "shall cause active member contributions for current service to be made." However, later in the section it is stated that active members "may elect to contribute to the system on their behalf." Members may make contributions to PERS on their own behalf to the extent permitted by law, with a dollar-for-dollar employer-matching contribution of up to 6% of the member's "pensionable earnings," as that term is defined in section 7102 (which excludes overtime compensation and bonuses). Mandatory participation in a defined contribution pension plan normally involves a minimum employee contribution requirement. The bill as amended does not set a minimum participant contribution rate for either the member or the employer, which could mean that members may choose to contribute nothing, and likewise, the employer would also make no contributions toward the member's retirement plan. The purpose of mandating participation in a pension plan when no minimum contribution to the plan is required is not apparent. Further, there may be serious tax-qualification issues involved with such an approach. Based on the Commission's understanding of the IRC tax-qualification rules, employee contributions to a defined contribution plan sponsored by a governmental entity can only be made on a pre-tax basis if plan membership is mandatory or there is a one-time irrevocable salary reduction agreement in place. Finally, the apparently optional nature of plan participation is contradicted in section 7106(d) which mandates a default investment option provision applicable to members who do not elect one and requiring that "the active member contribution in the default investment option shall be 6% of the active member's pensionable earnings."

Members of PERS would become fully vested in the employer contribution portion of the plan after three years of service. Presumably, non-vestees who terminate service prior to vesting would be entitled to a return of their own contributions to the plan, however, there is no specific provision for this contingency, beyond a somewhat vague reference to the return of "accumulated deductions" (a term which is not defined) in section 7115(f). Section 7113(b)(2) requires the forfeiture of the employer contribution portion of a non-vested member's account upon the death, "or other termination of public service of the active member," and permit the

## DISCUSSION (CONT'D)

forfeited balance of any such account to be used to defray the administrative expenses of PERS under section 7105(f).

Under current law, "school employees" (employees of the Pennsylvania State System of High 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).

The purpose is to permit eligible employees the option of participating in a defined contribution plan similar to those commonly available to other college and university employees throughout the U.S. 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. The maximum employer contribution rate of 9.29% for an independent retirement program was selected so that the value of the benefits provided by it would be comparable to the value of the benefits provided by SERS to the average state employee over the course of that employee's career in public service. The Teachers' Insurance and Annuity Association of America - College Retirement Equities Fund (TIAA-CREF) is the best known, oldest, and largest of the defined contribution plans in the field of education, and from 1982 until 2001, was the only vendor permitted to be approved by the affected employers as an alternative retirement plan. With the passage of Act 35 of 2001, the number of potential, alternative retirement program vendors available to higher education institution employees was expanded to include insurance companies and mutual fund companies with investment options meeting the requirements of a tax-qualified plan under the Internal Revenue Code. As of October 1, 2008, the following vendors were approved as qualified alternative retirement plans for PASSHE employees: TIAA-CREF, AIG Retirement, ING and Fidelity; with all but a small minority of employees electing TIAA-CREF as their alternative retirement program vendor.

With the passage of the bill as amended, it appears that new employees of these educational institutions would no longer have the option to select membership in an alternative retirement program such as TIAA-CREF. Beyond reducing employer costs associated with active member benefits, the rationale for mandating replacement of a well-established defined contribution plan (such as TIAA-CREF) with a new defined contribution plan providing a benefit of lesser value is unclear. Because the maximum employer contribution on behalf of active members would be limited to 6% under PERS, members of PERS will be entitled to a retirement benefit of lesser value relative to their colleagues who are members of an alternative retirement program such as TIAA-CREF. The reduced benefits available to new employees would create

## DISCUSSION (CONT'D)

a retirement benefit disparity between similarly situated educational employees who are required to become members of PERS and those employees still covered by TIAA-CREF and other authorized alternative retirement program vendors.

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, there would be no special benefit provisions for these groups of employees.

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 would almost certainly be challenged in the courts.

Both the PSERS and SERS Codes include provisions exempting the use of collective bargaining agreements or arbitration awards between the Commonwealth and its employees pertaining to pension or retirement benefit rights of employees. The bill as amended includes no provision precluding the use of collective bargaining agreements or arbitration awards for the purpose of providing employee pension benefits. The bill's sponsors may wish to consider



## **DISCUSSION (CONT'D)**

the effect that the absence of such a provision may have on PERS, when the intent of creating a new reduced benefit DC plan is apparently to control retirement benefit costs.

SERS members who are Pennsylvania State Police Officers now are granted special retirement rights and benefits such as superannuation at an earlier age with fewer mandatory years of service. The retirement age for most public safety employees is age 50, primarily due to the hazardous nature and physical demands of public safety work. In PERS, there are no special benefit provisions for public safety employees. By election of the Commonwealth, State Police Officers do not participate in Social Security old-age or disability benefits, and are subject to a mandatory retirement age of age 60 with 20 years of service (§205 of the Administrative code of 1929). If the bill as amended is enacted, the Commonwealth may find difficulty in recruiting and retaining State Police members, particularly when those members will be earning benefits that are less than other PERS members.

The bill as amended contains disability benefit provisions that are unclear. First, no standard of disability has been established (permanent or temporary). The employer is to continue matching contributions in the event of disability at the same rate that was provided before the disability occurred (Section 7112(b)). Additionally, contributions are to continue until the member attains age 65. There is no provision to cease the contribution prior to age 65 if the member is no longer disabled. If contributions are to cease, a provision for monitoring the status of disabled members through periodic medical review would need to be established. There is also no provision for a Workers' Compensation offset in the case of a member who is injured on the job.

Beyond payment of the member's account balance to the designated beneficiary upon the death of an active member, there are no special death benefit provisions to provide for the surviving spouse or children of a PERS member. The bill's sponsors may wish to consider whether the absence of any special disability benefits for members of PERS could interfere with recruiting and retaining employees, particularly hazardous duty personnel who may be exposed to a higher risk of injury in service.

Under PERS, the maximum employer contribution is 6% of compensation. Currently, the employer normal cost rate for both PSERS and SERS is greater than 6% of compensation. Therefore, the value of the employer-provided benefits to the new PERS members will generally be lower than the employer-provided benefits provided to current PSERS and SERS members.

## **DISCUSSION (CONT'D)**

### ***Investments***

Members of PERS will be provided with a variety of investment options, including lifestyle funds that are based upon age and projected retirement date. PERS will also make available investment options that represent a broad cross-section of asset classes and risk profiles, including low-cost investment alternatives. A composite fund may also be offered to participants which represents the entire portfolio return under management within PSERS or SERS. If an active member does not select a specific investment option, PERS will provide a default investment option that will be the lifestyle fund which most closely represents the current demographic of the active member and the projected retirement date of the active member.

The PERS Board will designate a third-party administrator to run the daily operations of the new retirement system. The third-party administrator will be responsible for providing investment guidance to members in accordance with pension industry standards, along with online administration and daily valuations of the member's account.

The PERS Board will not be held responsible for any investment losses incurred by members in the System or for the failure of any investment to earn a specific or expected return. The board will bear the expenses arising from allowing public employee participation in the System and for contribution deductions to the fund managers. All other expenses from the administration of the System will be assessed against the accounts created on behalf of active members, either by the fund managers or by the board.

Because PERS will be a governmental plan, not subject to the Employee Retirement Income Security Act (ERISA), there is no fiduciary standard to which PERS or the third-party administrator can be held. This may unduly jeopardize the retirement security of members subject to PERS.

### ***Ancillary Issues***

*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. It is unclear how or if REHP participation would be incorporated into the PERS plan.

## DISCUSSION (CONT'D)

*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.

Because ownership of the funds vests immediately with the employee at the time of contribution under a defined contribution plan, it is unclear to what extent the Public Employee Pension Forfeiture Act would apply to the individual retirement accounts of PERS members.

### **Closure of PSERS and SERS to New Members**

As noted previously, membership in PSERS and SERS would be closed to public employees hired by school or State employers within the Commonwealth after July 1, 2011. However, both retirement Systems 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 large increases in 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. Changes due to legislative action are to be amortized over a 10-year period. As the active membership declines within each System,

## **DISCUSSION (CONT'D)**

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.

Section 8328 of the PSERS Code and Section 5508 of the SERS Code specify methods to be used by the actuaries of the respective Systems to determine the “employer normal contribution rate” or employer normal cost and the total employer contribution rate, which consists of both the normal cost and the contributions required to fund the accrued liabilities of each plan, plus any amortization contribution requirement.

Both the PSERS and SERS Codes require the normal cost to be determined using "... a level percentage of the compensation of the average new active member..." However, the Systems apply different interpretations to the language. Using the SERS interpretation, the average new member, or entrant, to the System currently earns a benefit at the 2.5% annual accrual rate (Class AA members). The traditional method would be to develop the normal cost rate based upon current active members and the benefits to which each member is entitled. This method would be based upon a blending of accrual rates attributable to all active members, rather than new entrants only, and would result in a normal cost calculation that more closely approximates the normal costs of the Systems. According to the Commission's consulting actuary, PSERS is currently using the traditional normal cost method.

If the bill as amended is enacted, there would no longer be new members entering PSERS or SERS on which to determine the normal cost rate. The estimated actuarial cost for SERS for this actuarial note was determined assuming the normal cost rate would remain at the current level employing a “virtual” active member population. The Commission’s consulting actuary believes that the SERS’ method is reasonable. The Commission’s consulting actuary has also indicated that the PSERS’ method would be the preferred approach for determining the normal cost. Whichever method is chosen, it will require separate legislation and should be applied uniformly.

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.

## SUMMARY OF ACTUARIAL COST IMPACT

The Commission's consulting actuary has reviewed the bill as amended and the actuarial cost estimates provided to the Commission by the consulting actuaries for both PSERS and SERS. The results of these analyses are summarized in the following tables.

Table 1 shows the employer contribution rate and the employer contribution amount for school employers for FY 2011 to FY 2042 under (1) current law and (2) if the proposal in the bill as amended were enacted with a declining amortization period beginning in FY 2014. The appropriation payroll applicable to PSERS and PERS and the employer contribution change due to the bill as amended is also shown. Table 2 shows the employer contribution rate and the employer contribution amount for state (non-school) employers for FY 2011 to FY 2042 under (1) current law and (2) if the bill as amended were enacted with a declining amortization period beginning in FY 2012. The appropriation payroll applicable to SERS and PERS and the employer contribution change due to this amended bill is also shown.

As shown in Tables 1 and 2, the anticipated spike in the employer contribution rate in FY 2013 would still occur if the bill as amended were enacted. Based on the projection's lower normal cost attributable to new members entering PERS, there would be a reduced employer contribution requirement beginning in FY 2019 for PSERS employers and in FY 2012 for SERS employers.

Some of the reasons that SERS employers would realize immediate savings whereas PSERS employers would have additional short-term costs is the delay between the valuation date and the fiscal year for which the valuation determines contributions, the basis for the normal cost rate, the value of the benefits the normal cost rate represents, and when the bill as amended would be reflected in the System's valuation.

For SERS, the December 31, 2010, valuation is the basis for the FY 2011-2012 employer contribution. The SERS cost estimate reflects that the bill as amended would be reflected in the December 31, 2010, valuation through a reduced appropriation payroll for FY 2011-2012. The normal cost rate for the FY 2011-12 is for members accruing benefits during this period. Therefore, a reduction in the benefits earned during this period would result in a reduction in the costs for this period.

## **SUMMARY OF ACTUARIAL COST IMPACT (CONT'D)**

For PSERS, the June 30, 2010, valuation is the basis for the FY 2011-2012 contribution. The normal cost rate paid in FY 2011-2012 is for members who are expected to accrue benefits between July 1, 2010, and June 30, 2011. Effectively, the value of benefits earned in this upcoming period is paid for one year later. Therefore, changing the value of benefits earned after June 30, 2011, would not impact the dollar amount of the contribution. Under the bill as amended, PSERS would be closed to new hires after July 1, 2011, so any change in the normal cost would not be reflected until the June 30, 2012, valuation, which determines the FY 2013-2014 employer contribution. However the DC plan contributions would begin in FY 2011-2012, resulting in higher short-term costs for school employers.

It should also be noted that PSERS has a lower employer normal cost rate than SERS so it takes longer for the savings of the DC plan to present themselves under PSERS than SERS. These projections assume each of the System's assets would earn 8% each year of the projection. As membership in SERS and PSERS becomes increasingly inactive in nature, a lower valuation interest rate may be more appropriate as the investment allocation may become more conservative.

**SUMMARY OF ACTUARIAL COST IMPACT (CONT'D)**

**TABLE 1**

<b>Public School Employees' Retirement System (PSERS) and                      Potential Public Employees' Retirement System (PERS)                      Projected Employer Contribution Rates and Amounts for School Employers for Fiscal Year 2011 to 2042                      (\$ amounts in millions)</b>											
Fiscal Year Ending June 30	Total Approp- riation  Payroll	Current Law		Senate Bill 566 as amended by A08034						Increase/ (Decrease) Employer Contribution	
		PSERS		PSERS		PERS		Total Employer Contribution			
		Employer Contribution Rate	Amount	Appropri- ation Payroll	Employer Contribution Rate	Amount	Appropri- ation Payroll		Employer Contribution Rate		Amount
2011	\$13,510.0	8.22%	\$1,110.5	\$13,510.0	8.22%	\$1,110.5	N/A	N/A	N/A	\$1,110.5	\$0.0
2012	13,920.9	10.59%	1,474.2	13,920.9	10.59%	1,474.2	\$708.3	6.00%	\$42.5	1,516.7	42.5
2013	14,345.3	29.22%	4,191.7	14,345.3	29.22%	4,191.7	1,405.3	6.00%	84.3	4,276.0	84.3
2014	14,797.7	32.09%	4,748.6	14,089.4	33.28%	4,688.9	2,095.7	6.00%	125.7	4,814.6	66.0
2015	15,280.1	33.60%	5,134.1	13,874.8	36.18%	5,019.9	2,800.6	6.00%	168.0	5,187.9	53.8
2016	15,794.5	33.27%	5,254.8	13,698.8	37.11%	5,083.6	3,517.0	6.00%	211.0	5,294.6	39.8
2017	16,341.3	32.74%	5,350.1	13,540.6	37.83%	5,122.4	4,225.7	6.00%	253.5	5,375.9	25.8
2018	16,926.7	32.06%	5,426.7	13,409.7	38.34%	5,141.3	4,946.2	6.00%	296.8	5,438.1	11.4
2019	17,557.7	31.27%	5,490.3	13,332.0	38.60%	5,146.1	5,699.3	6.00%	342.0	5,488.1	(2.2)
2020	18,232.1	30.42%	5,546.2	13,285.9	38.72%	5,144.3	6,490.0	6.00%	389.4	5,533.7	(12.5)
2021	18,948.0	29.56%	5,601.0	13,248.8	38.79%	5,139.2	7,332.4	6.00%	439.9	5,579.1	(21.9)
2022	19,703.2	28.75%	5,664.7	13,213.2	38.88%	5,137.3	8,217.4	6.00%	493.0	5,630.3	(34.4)
2023	20,493.7	27.95%	5,728.0	13,161.3	39.00%	5,132.9	9,152.6	6.00%	549.2	5,682.1	(45.9)
2024	21,321.5	27.18%	5,795.2	13,104.1	39.12%	5,126.3	10,146.9	6.00%	608.8	5,735.1	(60.1)
2025	22,185.0	26.44%	5,865.7	13,032.4	39.29%	5,120.4	11,209.5	6.00%	672.6	5,793.0	(72.7)
2026	23,081.8	25.74%	5,941.3	12,935.0	39.53%	5,113.2	12,349.7	6.00%	741.0	5,854.2	(87.1)
2027	24,006.8	25.05%	6,013.7	12,797.3	39.86%	5,101.0	13,563.0	6.00%	813.8	5,914.8	(98.9)
2028	24,958.6	24.40%	6,089.9	12,608.9	40.33%	5,085.2	14,851.7	6.00%	891.1	5,976.3	(113.6)
2029	25,937.5	23.78%	6,167.9	12,374.4	40.93%	5,064.8	16,217.0	6.00%	973.0	6,037.8	(130.1)
2030	26,944.0	23.19%	6,248.3	12,092.3	41.69%	5,041.3	17,666.8	6.00%	1,060.0	6,101.3	(147.0)
2031	27,978.1	22.63%	6,331.4	11,761.0	42.63%	5,013.7	19,210.2	6.00%	1,152.6	6,166.3	(165.1)
2032	29,041.5	22.10%	6,418.2	11,374.7	43.80%	4,982.1	20,839.2	6.00%	1,250.4	6,232.5	(185.7)
2033	30,136.5	19.46%	5,864.6	10,926.3	39.37%	4,301.7	22,553.5	6.00%	1,353.2	5,654.9	(209.7)
2034	31,268.4	18.16%	5,678.3	10,429.2	38.23%	3,987.1	24,349.3	6.00%	1,461.0	5,448.1	(230.2)
2035	32,446.3	16.82%	5,457.5	9,892.8	36.67%	3,627.7	26,233.4	6.00%	1,574.0	5,201.7	(255.8)
2036	33,675.8	15.65%	5,270.3	9,326.5	35.38%	3,299.7	28,211.7	6.00%	1,692.7	4,992.4	(277.9)
2037	34,956.6	14.33%	5,009.3	8,723.2	33.07%	2,884.7	30,274.0	6.00%	1,816.4	4,701.1	(308.2)
2038	36,292.1	13.88%	5,037.3	8,080.4	34.06%	2,752.2	32,431.4	6.00%	1,945.9	4,698.1	(339.2)
2039	37,690.6	14.64%	5,517.9	7,416.6	41.37%	3,068.3	34,680.3	6.00%	2,080.8	5,149.1	(368.8)
2040	39,153.0	14.47%	5,665.4	6,721.6	45.26%	3,042.2	36,998.6	6.00%	2,219.9	5,262.1	(403.3)
2041	40,680.0	13.15%	5,349.4	5,999.7	42.39%	2,543.3	39,444.9	6.00%	2,366.7	4,910.0	(439.4)
2042	42,266.6	12.18%	5,148.1	5,268.1	40.92%	2,155.7	42,025.7	6.00%	2,521.5	4,677.2	(470.9)
Total:			\$169,590.6			\$134,842.9			\$30,590.7	\$165,433.6	(\$4,157.0)

SUMMARY OF ACTUARIAL COST IMPACT (CONT'D)

TABLE 2

State Employees' Retirement System (SERS) and Potential Public Employees' Retirement System (PERS) Projected Employer Contribution Rates and Amounts for State (non-school) Employers for Fiscal Year 2011 to 2042 (\$ amounts in millions)											
Fiscal Year Ending June 30	Total Appropriation Payroll	Current Law		Senate Bill 566 as amended by A08034						Increase/ (Decrease) Employer Contribution	
		SERS		SERS		PERS		Total Employer Contribution			
		Employer Contribution Rate	Amount	Appropriation Payroll	Employer Contribution Rate	Amount	Appropriation Payroll		Employer Contribution Rate		Amount
2011	\$5,936.0	5.64%	\$335.0	\$5,936.0	5.64%	\$335.0	N/A	N/A	N/A	\$335.0	\$0.0
2012	6,131.9	7.98%	489.0	6,024.3	7.95%	478.8	\$107.5	6.00%	\$6.5	485.3	(3.7)
2013	6,334.2	26.66%	1,688.4	5,941.2	27.79%	1,651.2	393.0	6.00%	23.6	1,674.8	(13.6)
2014	6,543.3	29.22%	1,911.7	5,829.9	31.66%	1,845.6	713.3	6.00%	42.8	1,888.4	(23.3)
2015	6,759.2	27.72%	1,873.5	5,705.1	31.06%	1,771.9	1,054.1	6.00%	63.2	1,835.1	(38.4)
2016	6,982.2	27.46%	1,917.0	5,565.9	31.96%	1,778.8	1,416.3	6.00%	85.0	1,863.8	(53.2)
2017	7,212.7	27.09%	1,953.9	5,406.8	32.85%	1,776.0	1,805.8	6.00%	108.3	1,884.3	(69.6)
2018	7,450.7	26.64%	1,985.2	5,240.5	33.70%	1,765.9	2,210.2	6.00%	132.6	1,898.5	(86.7)
2019	7,696.5	26.16%	2,013.4	5,068.2	34.55%	1,751.1	2,628.3	6.00%	157.7	1,908.8	(104.6)
2020	7,950.5	25.69%	2,042.1	4,892.4	35.47%	1,735.5	3,058.1	6.00%	183.5	1,919.0	(123.1)
2021	8,212.9	25.22%	2,071.2	4,715.9	36.46%	1,719.3	3,497.0	6.00%	209.8	1,929.1	(142.1)
2022	8,483.9	24.76%	2,100.9	4,532.2	37.55%	1,702.0	3,951.7	6.00%	237.1	1,939.1	(161.8)
2023	8,763.9	24.32%	2,131.5	4,344.6	38.77%	1,684.2	4,419.3	6.00%	265.2	1,949.4	(182.1)
2024	9,053.1	23.89%	2,163.0	4,151.7	40.13%	1,665.9	4,901.4	6.00%	294.1	1,960.0	(203.0)
2025	9,351.8	23.48%	2,195.5	3,953.3	41.66%	1,647.0	5,398.5	6.00%	323.9	1,970.9	(224.6)
2026	9,660.5	23.07%	2,229.1	3,753.5	43.37%	1,628.0	5,906.9	6.00%	354.4	1,982.4	(246.7)
2027	9,979.3	22.69%	2,263.9	3,554.6	45.27%	1,609.0	6,424.6	6.00%	385.5	1,994.5	(269.4)
2028	10,308.6	22.31%	2,299.7	3,351.5	47.43%	1,589.7	6,957.1	6.00%	417.4	2,007.1	(292.6)
2029	10,648.8	21.94%	2,336.7	3,148.9	49.87%	1,570.4	7,499.9	6.00%	450.0	2,020.4	(316.3)
2030	11,000.2	21.59%	2,375.0	2,945.5	52.66%	1,551.0	8,054.7	6.00%	483.3	2,034.3	(340.7)
2031	11,363.2	21.25%	2,414.5	2,741.8	55.86%	1,531.6	8,621.3	6.00%	517.3	2,048.9	(365.6)
2032	11,738.2	20.92%	2,455.3	2,536.2	59.62%	1,512.0	9,201.9	6.00%	552.1	2,064.1	(391.2)
2033	12,125.5	18.83%	2,283.7	2,333.4	54.81%	1,278.9	9,792.1	6.00%	587.5	1,866.4	(417.3)
2034	12,525.7	17.83%	2,233.3	2,132.3	54.67%	1,165.8	10,393.4	6.00%	623.6	1,789.4	(443.9)
2035	12,939.0	17.37%	2,247.8	1,942.3	57.52%	1,117.2	10,996.7	6.00%	659.8	1,777.0	(470.8)
2036	13,366.0	15.87%	2,121.2	1,760.7	52.64%	926.8	11,605.3	6.00%	696.3	1,623.1	(498.1)
2037	13,807.1	15.39%	2,125.1	1,587.2	54.58%	866.2	12,219.9	6.00%	733.2	1,599.4	(525.7)
2038	14,262.7	15.46%	2,205.1	1,420.4	62.00%	880.7	12,842.3	6.00%	770.5	1,651.2	(553.9)
2039	14,733.4	16.43%	2,420.5	1,260.8	81.67%	1,029.7	13,472.5	6.00%	808.4	1,838.1	(582.4)
2040	15,219.6	14.92%	2,270.8	1,105.8	73.45%	812.3	14,113.8	6.00%	846.8	1,659.1	(611.7)
2041	15,721.8	14.14%	2,223.0	954.8	72.83%	695.4	14,767.0	6.00%	886.0	1,581.4	(641.6)
2042	16,240.6	13.21%	2,144.7	809.0	9.53%	77.1	15,431.7	6.00%	925.9	1,003.0	(1,141.7)
Total:			\$65,520.7			\$43,150.0			\$12,831.3	\$55,981.3	\$(9,539.4)



## **POLICY CONSIDERATIONS**

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

Creation of a New Public Pension Bureaucracy. ( ) The bill as amended would create an entirely new public employee retirement system bureaucracy, which, in time, would eventually replace both PSERS and SERS. As with the creation of any new, large governmental entity, the establishment of PERS will be an expensive and complex undertaking. If it is the intent of Commonwealth policy makers to replace the two existing, statewide, defined benefit pension systems with a single defined contribution system for public employees, it may be more efficient and cost effective to do so by adding one or more defined contribution benefit tiers to PSERS and SERS. Both PSERS and SERS already possess the physical infrastructure, systems, personnel and expertise to successfully administer such a retirement benefit plan.

Closure of PSERS and SERS. ( ) Under the bill as amended, PSERS and SERS would be closed to new members. Both retirement Systems 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, and present funding challenges that will need to be addressed in the future through modification of the Systems’ respective retirement statutes.

Benefit Value and Security. ( ) While a detailed benefit comparison was beyond the scope of the Commission’s actuarial note, the DC plan proposed in the bill as amended would provide future employees with a retirement income that is likely to be less valuable, predictable and secure than PSERS’ or SERS’ traditional DB plans. During the past decade, defined contribution plan participants have endured two major market down-turns that have negatively affected the investment performance of their retirement accounts; the first during the period from roughly 2001-2003, and most recently in 2008. In view of these past market fluctuations, 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.

## POLICY CONSIDERATIONS (CONT'D)

Appropriate Delegation of Legislative Authority. ( ) The bill as amended empowers the PERS Board to develop the details of major plan design elements and administrative details by rule or regulation. The General Assembly and the Governor must determine if the broad powers afforded the PERS 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 as amended, there are no special benefit provisions for these groups of employees. The uniform benefit level under PERS 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 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 would almost certainly be challenged in the courts. The lack of a severability clause in the bill could result in it being entirely voided.

Treatment of Educational Employees. ( ) Under current law, "school employees" (employees of 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 PSERS or SERS. Under the bill as amended, it appears that new employees of these educational institutions would no longer have the option to select membership in an alternative retirement program such as TIAA-CREF. Beyond reducing employer costs associated with active member benefits, the rationale for mandating replacement of a well-established defined contribution plan (such as TIAA-CREF) with a new defined contribution providing a benefit of lesser value is unclear.

## POLICY CONSIDERATIONS (CONT'D)

Adequacy of Disability and Death Benefits for Hazardous Duty Personnel. ( ) Historically, it has been the practice of the Commonwealth to provide special disability and death benefits to public safety employees due to the hazardous nature of such employment. The bill as amended represents a major departure from past practice by providing no such special benefits for hazardous duty personnel.

Disparate Treatment. ( ) The Commonwealth has elected to exclude members of the State Police from Social Security coverage. Therefore, those employees would receive lesser benefits than other PERS members.

Collective Bargaining and Arbitration. (-) Both the PSERS and SERS Codes currently contain specific provisions prohibiting the use of collective bargaining agreements or arbitration awards between public employers and employees to award benefits. These provisions were included partly in reaction to cases in which enhanced benefits had in the past been awarded to certain groups of employees. The amended bill as written includes no specific provision prohibiting the use of collective bargaining agreements or arbitration awards to award additional employee pension benefits, which could lead to the use of such methods to award supplementary or enhanced benefits not provided under PERS.

Potential Liability Exposure. (-) As drafted, the bill as amended contains numerous plan design deficiencies and ambiguities. If left unaddressed, these deficiencies may expose the PERS Board, the Commonwealth, and other public employers to litigation brought by employees over retirement benefit entitlement issues.

Tax Qualification. (-) The bill as amended states that PERS shall be administered as a tax-qualified plan under the IRC. However, this declaration alone may prove insufficient to ensure the tax-qualified treatment of PERS. Based on the Commission's understanding of the IRC tax-qualification rules, employee contributions to a DC plan sponsored by a governmental entity can only be made on a pre-tax basis if plan membership is mandatory or there is a one-time irrevocable salary reduction agreement in place. The bill as amended should be reviewed by qualified legal counsel specializing in tax-qualification issues to ensure IRC compliance.

## **POLICY CONSIDERATIONS (CONT'D)**

Retired Employee Health Program. ( ) The Retired Employee Health Program (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 the employee's age at retirement. It is unclear how or if REHP participation would be incorporated into the PERS plan.

Pension Forfeiture Act. ( ) It is unlikely that the Public Employee Pension Forfeiture Act, 1978, July 8, P. L. 752, No 176, as amended, would apply to the new defined contribution plan, since the employee's share of the funds vests immediately with the employee at the time of contribution.

Inadequate Technical Provisions. (-) In reviewing the bill as amended, the Commission staff noted numerous deficiencies in the areas of plan design, drafting ambiguities, drafting inconsistencies, the use of undefined terms, and the use of apparently contradictory language. The bill should be thoroughly reviewed and revised to correct these deficiencies prior to enactment. Following are the more significant issues noted by the staff.

*Funding of Administrative Expenses.* The bill as amended is unclear on how the administrative expenses of PERS are to be funded. Under section 7105(f), the PERS Board will be required to submit an annual budget to the General Assembly for the administrative expenses of the System. The approved expenses are to be paid "in whole or in part" from member "nonvested forfeitures" (a term which is not defined) in PERS, and reference is also made to the payment of directed commissions by the board. Section 7108 states that, "all other expenses arising from the administration of the System," are to be paid from the individual retirement accounts of active members of the System. The creation of a large governmental institution such as PERS will be costly. Because PERS will initially have no assets and few members, it seems likely that the current funding process provided for in the bill as amended will prove insufficient, at least in the early years of operation. It appears likely that appropriations, either from the Commonwealth General Fund or some other source identified and authorized by the General Assembly, will be necessary to meet the initial and ongoing annual administrative funding requirements of PERS.

## POLICY CONSIDERATIONS (CONT'D)

*Disability Provisions.* The disability retirement provisions contained in the bill as amended are unclear. The bill as amended indicates that the employer is to continue to make matching contributions in the event of disability at the same rate that was provided for before the disability occurred (section 7112(b)). However, there is no provision in place to determine what qualifies as a disability and if that disability is permanent or temporary. In addition, the contributions are to continue until age 65. There is no provision to cease the contribution prior to age 65 if the member is no longer disabled. If contributions are to cease, a provision for monitoring the status of disabled members through a periodic medical review would need to be added. The bill as amended provides no guidance as to the ongoing contributions if a disabled member withdraws part or all of the account balance. Since the employer contribution is a match of the member contribution, up to 6% of payroll, the potential exists for the disability benefit to be zero.

*Inconsistent Effective Dates.* The definition of public employee in section 7102 of the bill as amended refers to employees that begin public service after November 30, 2011. However, other sections make repeated references to an effective date of after July 1, 2011.

*Vesting and Treatment of Non-Vested Members.* The vesting provisions require clarification. Members of PERS would become fully-vested in the employer contribution portion of the plan after three years of service. Presumably, employees who terminate service prior to vesting would be entitled to a return of their own contributions to the plan, however, there is no specific provision for this contingency, beyond a reference to the return of “accumulated deductions” (a term which is not defined) in section 7115(f). The bill as amended should clearly indicate that the account balance derived from employee contributions adjusted for earnings and expenses is always 100% vested. Also, the bill as amended provides that a part-time member “shall only be vested if the member is compensated for at least 1,000 hours per year” (section 7113(a)). This provision should be clarified to indicate that three years of at least 1,000 hours per year is required to be vested in the account balance due to employer contributions. Section 7113(b)(2) requires the forfeiture of the employer contribution portion of a non-vested member’s account upon the death, “or other termination of public service of the active member,” and would permit the balance of any such account to be used to defray the administrative expenses of PERS under section 7105(f).

## POLICY CONSIDERATIONS (CONT'D)

*Status of Members Returning to Service.* The treatment of former active members of SERS and PSERS (vestees, inactive members and annuitants) who return to employment following a break in service is not clear. Section 7115(d) seems to indicate that membership in PERS would be mandatory only for those employees who enter into public service, “for the first time after July 1, 2011.” Likewise, section 7117(1) indicates that PERS membership would not be mandatory for any employee who is employed prior to July 1, 2011. However, section 7117(2) of the bill as amended contains the contradictory and confusing requirement that PERS membership, “shall apply to any person who is a public school employee or state employee before July 1, 2011, and who is not a public employee on July 1, 2011, *but reenters public service after July 1, 2011.*”

*Superannuation Age.* Section 7115(f) refers to superannuation age. However, superannuation age is not defined in the bill as amended, and superannuation age is generally not relevant for members in a DC plan.

*Optional or Mandatory Nature of Membership.* The nature of membership in PERS requires clarification. As written, membership in PERS is mandatory, yet contributions appear to be voluntary. Mandatory participation in a defined contribution pension plan normally involves a minimum contribution requirement. The bill as amended does not set a minimum participant contribution rate for either the member or the employer, which could mean that members may choose to contribute nothing, and likewise, the employer would also make no contributions toward the member’s retirement plan. The purpose of mandating participation in a defined contribution pension plan when no minimum contribution to the plan is required is not apparent. Further, there may be serious tax-qualification issues involved with such an approach. Based on the Commission’s understanding of the IRC tax-qualification rules, employee contributions to a defined contribution plan sponsored by a governmental entity can only be made on a pre-tax basis if plan membership is mandatory or there is a one-time irrevocable salary reduction agreement in place. Finally, the apparently optional nature of plan participation is contradicted in section 7106(d) which mandates a default investment option provision applicable to members who do not elect one and requiring that “the active member contribution in the default investment option shall be 6% of the active member’s pensionable earnings.” It is also unclear how often or if a member may change the rate of contribution to the plan.

## **POLICY CONSIDERATIONS (CONT'D)**

*Service Credit.* Section 7114(b) refers to credited service. However, credited service is not defined in the bill as amended and is generally not relevant for members in a DC plan.

*Municipal Employees.* Section 7117(1) refers to municipal employees. Since municipal employees are not covered by PERS this reference should be deleted prior to enactment.

*Board Membership.* The bill as amended does not include municipal employees in PERS, but the chairman of the Pennsylvania Municipal Retirement System (PMRS) is a member of the PERS Board (Section 7104(b)).

## **COMMISSION RECOMMENDATION**

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 above.

## **ATTACHMENTS**

Actuarial note provided by Katherine A. Warren and Timothy J. Nugent of Milliman, Inc.

Actuarial cost estimate provided by Buck Consultants, consulting actuary for the Public School Employees' Retirement System.

Actuarial cost estimate provided by the Hay Group, consulting actuary for the State Employees' Retirement System.

Senate Bill Number 566, Printer's Number 577.

Amendment Number 08034.