

Background for the Pension Debate

presented to the

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Today's Discussion

- Role of the Independent Fiscal Office.
- Overview of the two major state pension plans and their funding.
- Unfunded liabilities: How did they occur? What are the projected trends?
- Five-year projections (current law) for pension expenditures in the PA budget.

Independent Fiscal Office

- The Independent Fiscal Office (IFO) is a nonpartisan, independent agency that provides analysis of fiscal, economic and budgetary issues.
- The IFO does not take positions on issues, proposals or policies.
- Our role today is to provide general data and background.
 - With the exception of making five-year projections of General Fund appropriations under current law, the office has not performed its own analysis of pension funding.
 - Data in this presentation generally are derived from the comprehensive annual financial reports, actuarial valuations and budget materials published by SERS and PSERS.

SERS and PSERS Snapshot

	SERS ¹	PSERS ²
Members (active, inactive & retired)	233,734	609,776
Fund Assets	\$27.2 billion	\$53.3 billion
10-Year Average Funding Sources	13% member 17% employer 70% investments	17% member 16% employer 67% investments
Funded Status	59.3%	62.0%
Annual Benefits Paid ³	\$2.9 billion	\$6.1 billion

¹ As of 12/31/2014. ² As of 6/30/2014. ³ Calendar year 2014

Current Pension Plan Funding

- Employee contributions (percent of salary).
 - SERS: 6.25%
 - PSERS: 7.5%

- Investment earnings.
 - Assumed 7.5% long-term rate of return. Actual earnings are based on market conditions.
 - Significant losses during the 2008-2009 recession.

- Employer contributions.
 - Determined actuarially after accounting for fund liabilities, employee contributions and investment earnings.
 - Affected by “collars” that reduce contributions below actuarially determined levels.

Key Terminology

- **Employer normal cost** – the annual employer cost of benefits attributable to the current year of service.
- **Unfunded accrued liability (UAL)** – the difference between the actuarial value of assets and the actuarial value of pension liabilities (benefits).
- **Annual required contribution (ARC)** – the actuarially determined employer contribution. Includes: (1) the employer normal cost and (2) amortization of the UAL.

2014-15 Employer Rate

Component	SERS	PSERS
Normal Cost (NC)	5.00%	8.46%
Unfunded Accrued Liability (UAL)	26.41%	17.51%
<u>Act 120 Collars</u>	<u>-10.91%</u>	<u>-5.47%</u>
Total Employer Rate	20.50%	20.50%

Notes: (1) Excludes health insurance contribution rate of 0.9% for PSERS. (2) The SERS normal cost is computed based on the cost of benefits earned by a new member. The PSERS normal cost is based on an average of the costs for all members. PSERS reports that the cost for a new member is approximately 3%. Sources: SERS 2014 Actuarial Report (June 2015) and PSERS June 30, 2014 Actuarial Valuation (January 2015)

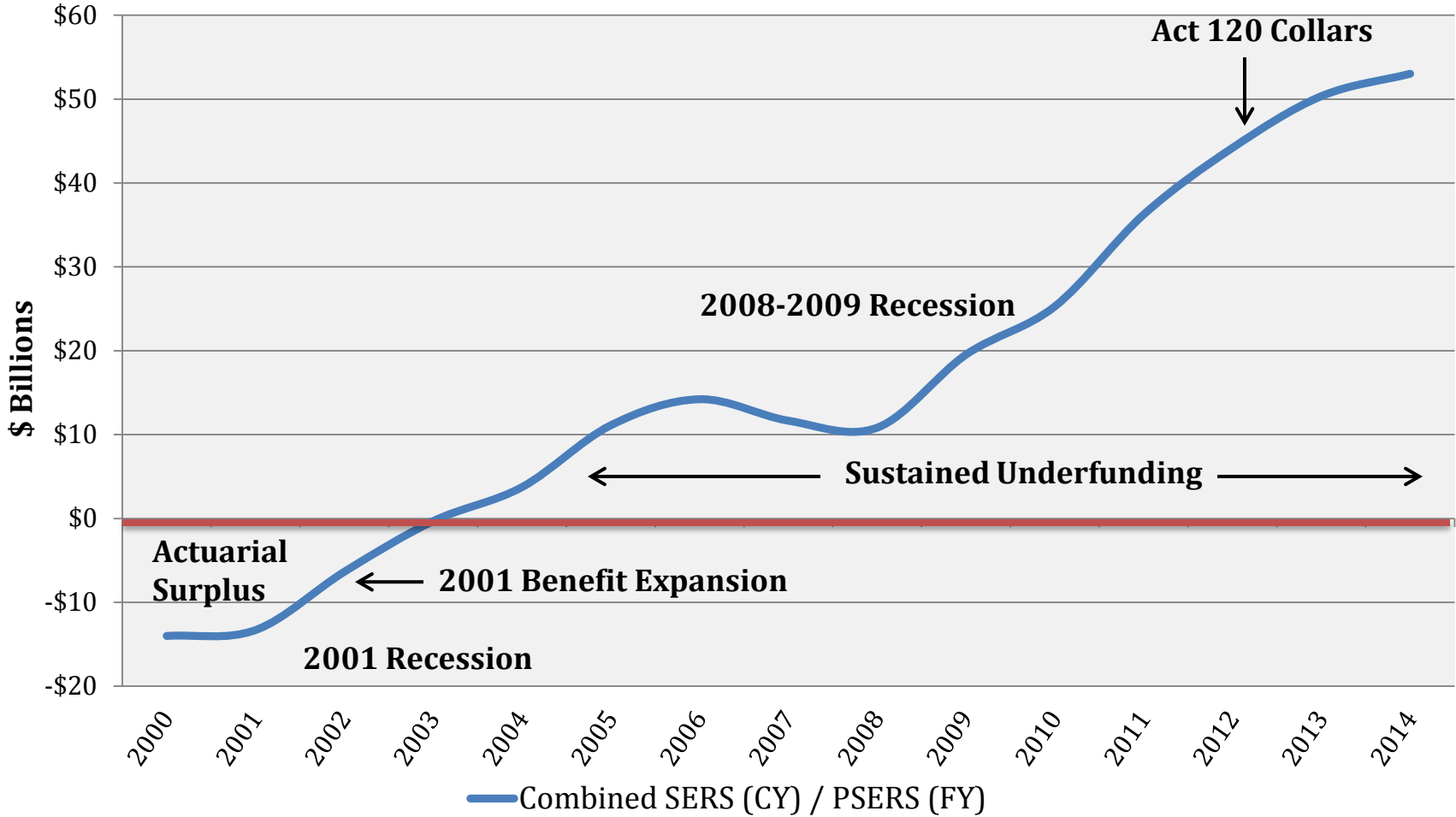
Unfunded Accrued Liabilities

Most Recent Actuarial Valuations

	SERS	PSERS	Total
Actuarial Value of Assets	\$26.6	\$57.3	\$83.9
Actuarial Accrued Liability	<u>44.8</u>	<u>92.5</u>	<u>137.3</u>
Assets Minus Liabilities (Unfunded Liability)	-18.2	-35.1	-53.3

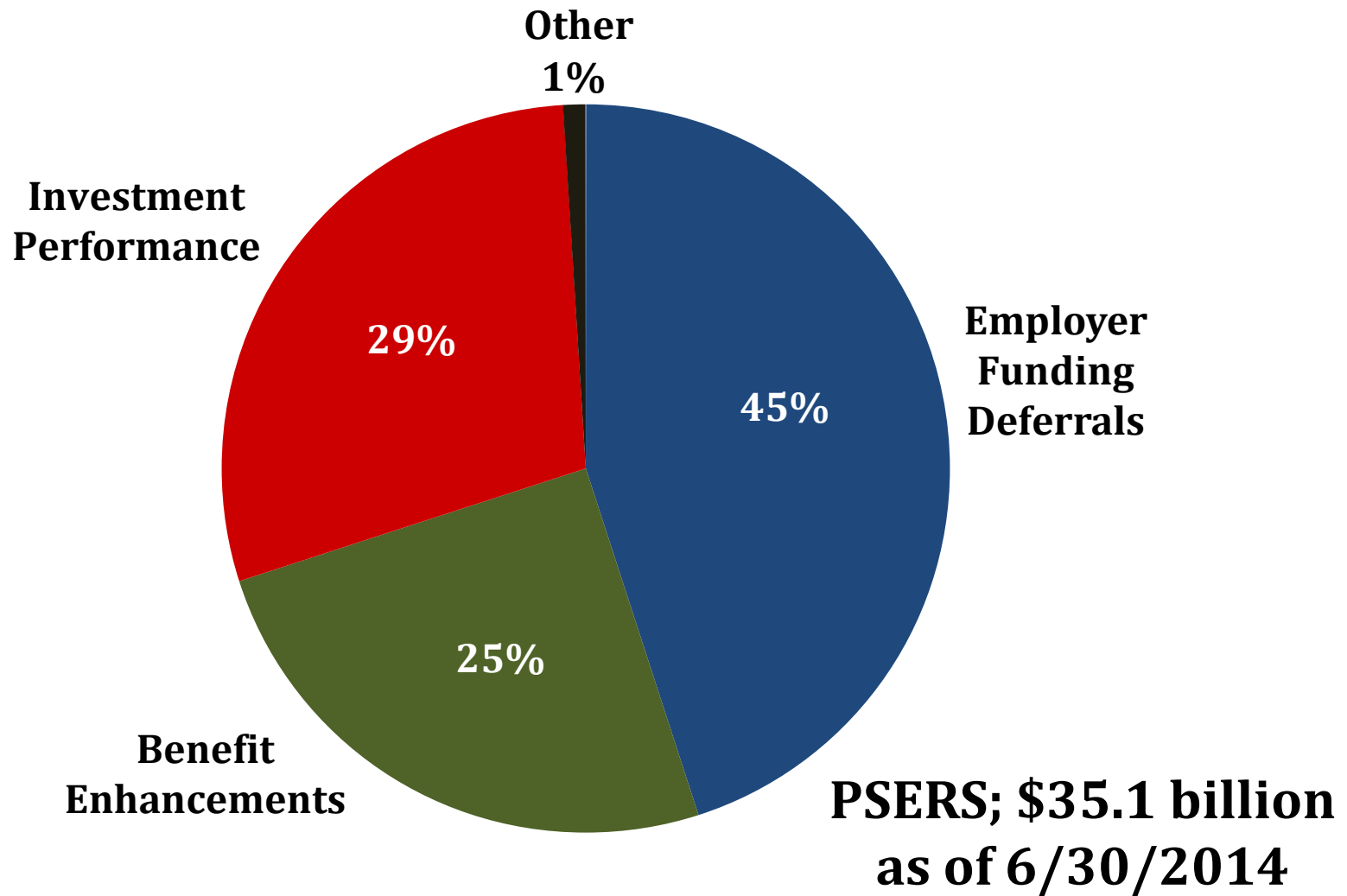
Note: Dollar amounts in billions. Sources: SERS 2014 Actuarial Report (June 2015) and PSERS June 30, 2014 Actuarial Valuation (January 2015)

Unfunded Liability History



Sources: SERS Comprehensive Annual Financial Reports; PSERS Actuarial Valuations; multiple years.

Sources of Unfunded Liability



Sensitivity of Earnings Assumption

- Estimates of the unfunded liabilities of the two pension systems are based on the 7.5% earnings assumption.
- Unfunded liabilities increase when the earnings assumption is reduced.
- A one percentage point reduction in the long-term rate of return (7.5% to 6.5%) increases liabilities:
 - SERS: ~\$4.2 billion
 - PSERS: ~\$9.8 billion
 - Total: ~\$14.0 billion

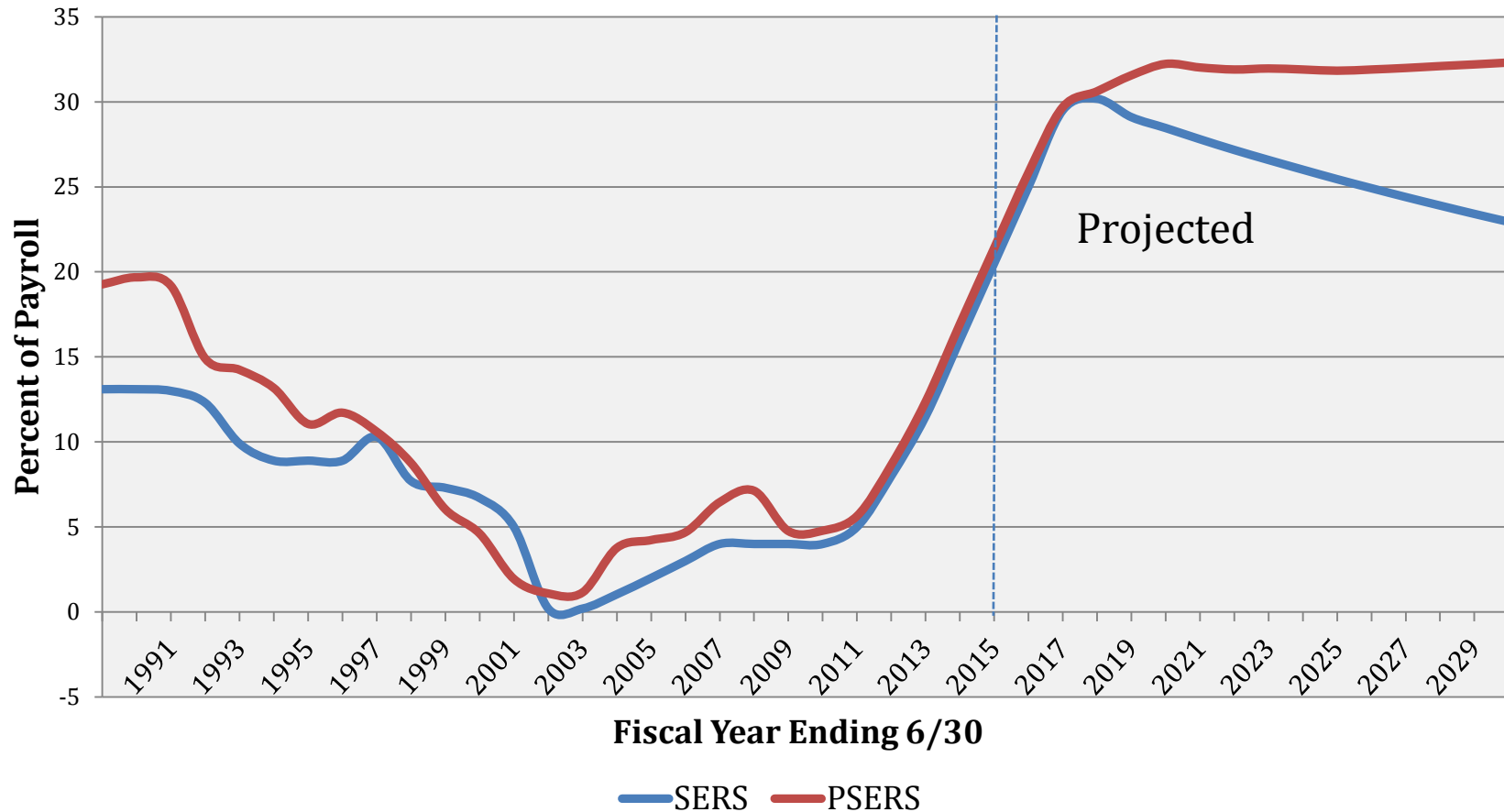
Unfunded Accrued Liabilities

Projected UAL – Selected Fiscal Years

Fiscal Year	SERS	PSERS	Total
2016-17	18.4	41.4	59.8
2017-18	18.0	42.9	60.9
<u>Out-Years</u>			
2024-25	15.6	37.2	52.8
2029-30	13.3	27.0	40.3

Note: Dollar amounts in billions. Sources: SERS 2015 Supplemental Budget Information (March 2015) and PSERS Current Employer Contribution Rate and 30 Year Projections (December 2014)

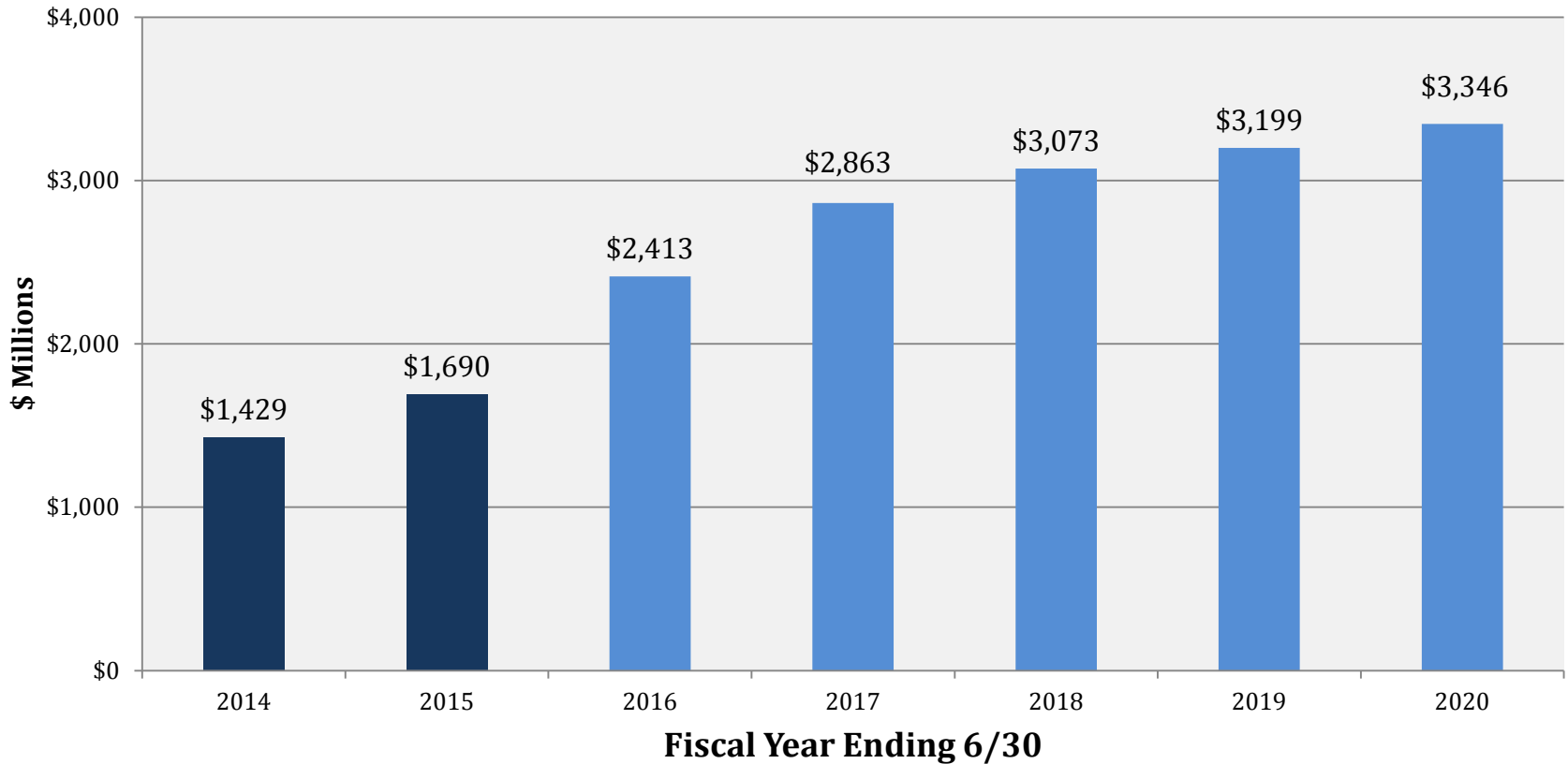
Employer Contribution Rates



Sources for projections: SERS 2015 Supplemental Budget Information (March 2015) and PSERS Current Employer Contribution Rate and 30 Year Projections (December 2014)

Pension Projections

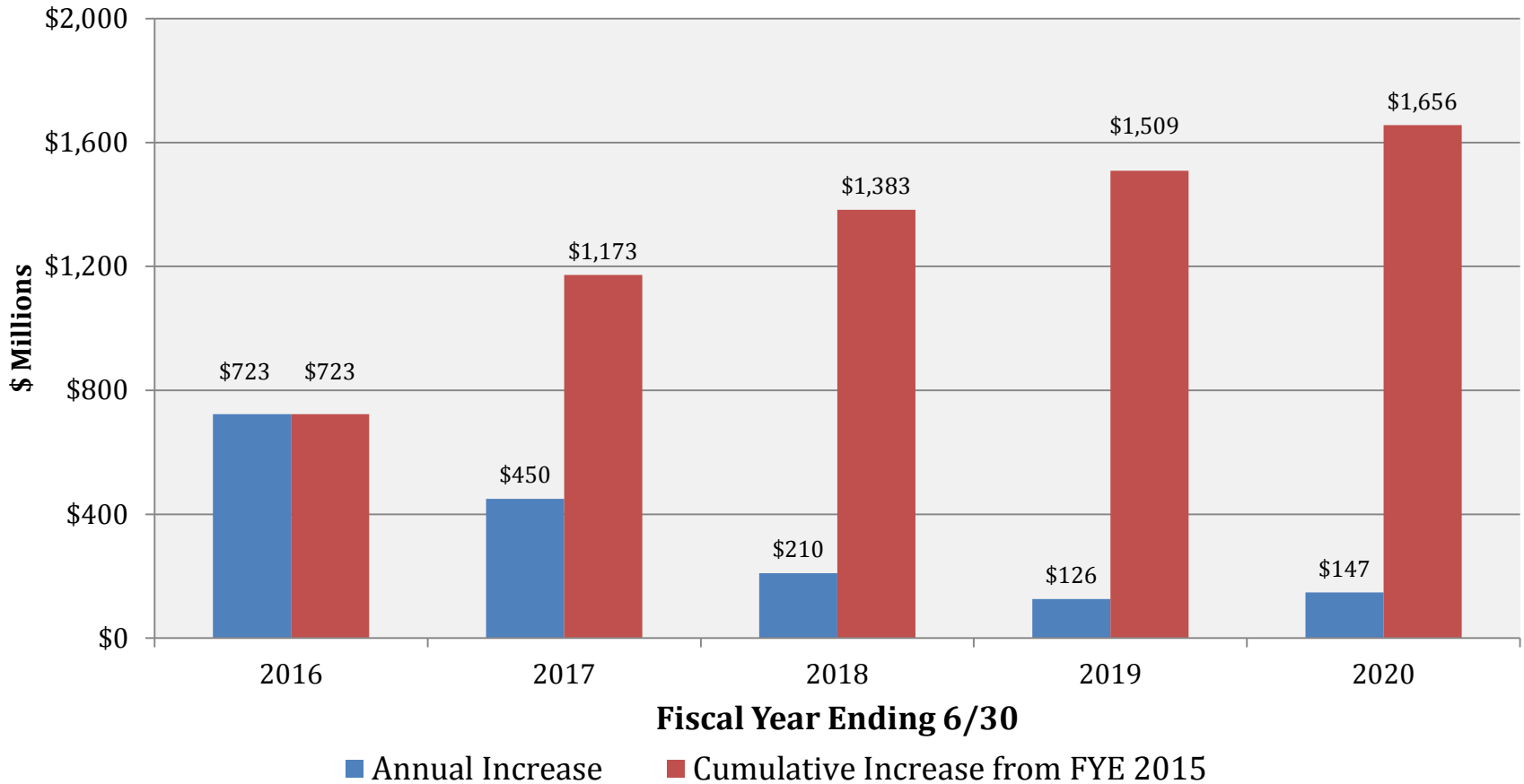
General Fund Appropriations SERS & PSERS Total



Source: Pennsylvania's Economic & Budget Outlook; Fiscal Years 2014-15 to 2019-20, Independent Fiscal Office, November 2014.

Pension Projections

General Fund - Annual and Cumulative Increases



Source: Pennsylvania's Economic & Budget Outlook; Fiscal Years 2014-15 to 2019-20, Independent Fiscal Office, November 2014.

Pension Proposals

- Proposed legislation:
 - **Senate Bill 1** (vetoed) – moves new employees to a hybrid defined contribution / cash balance plan.
 - **House Bill 727** – closes defined benefit plans and moves new employees to defined contribution plans.
 - **House Bill 900** – shortens the amortization periods to pay the unfunded liability. Eliminates the rate collars.
- Executive Budget proposal – issue pension obligation bonds and limit investment fees to reduce unfunded liabilities. Debt service on bonds to be paid by proceeds from modernizing the PA liquor system.

Thank You

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