



## INDEPENDENT FISCAL OFFICE

**TO:** Governor Josh Shapiro  
All Members of the General Assembly

**FROM:** Matthew Knittel, Director  
Independent Fiscal Office

**DATE:** October 26, 2023

**RE:** Actuarial Note for House Bill 1505, Printer's Number 1712 Amendment A01961

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The Independent Fiscal Office (IFO) submits an actuarial note for **Amendment A01961 to House Bill 1505, Printer's Number 1712** in accordance with section 615-B of the Administrative Code of 1929. Due to the material cost impact of the amendment on the bill, the IFO submitted a formal request to its contracted actuary (Milliman) for an actuarial note. A copy of the actuary's note is attached. Amendment A01961 is similar to Amendment A01959 to House Bill 1415, Printer's Number 1583. The analysis submitted by the State Employees' Retirement System (SERS) for Amendment A01959 served as the basis for Milliman's analysis.

### Summary of Provisions

The legislation would amend Title 71 (State Government) to provide supplemental annuities to State Police officers who retired prior to July 1, 2010. The legislation would enact changes to current statute that relate to annual salary cost of living adjustments (COLAs) for certain public officials.

- The legislation would provide for a supplemental annuity to begin on July 1, 2023 for eligible SERS annuitants.
- To be eligible, annuitants must be retired prior to July 1, 2010 and must be a former State Police officer who is a superannuation, withdrawal or disability annuitant prior to the commencement of the COLA.
- Beneficiaries and survivor annuitants of members who died prior to July 1, 2023 would not be eligible.
- Repeals current law that provides members of the judiciary, legislators, the Governor and other elected and appointed officials annual salary COLAs based on the CPI-U. These repeals would be effective the first November 30 or December 31 following enactment.
- Supplemental annuities for qualified retired State Police officers would only go into effect if the salary COLA repeal for judicial, legislative and other public officials goes into effect.
- The amount of the supplemental annual annuity is a prescribed dollar amount based on the retirement date of the annuitant. The full schedule is below.

Retirement Effective Date	Annual Annuity Increase
7/1/2000-6/30/2010	\$1,000
7/1/1990-6/30/2000	\$2,000
On or Prior to 6/30/1990	\$3,000

### Review of Findings

The proposed amendment would not change the prescribed supplemental annuities to eligible SERS retirees in any way. Amendment A01961 would have an additional actuarial impact on SERS and the table below details the projected changes.

Impacts of Amendment A01961 to House Bill 1505, P.N. 1712			
	Base	A01961	Change
Commencement Date	7/1/2023	7/1/2023	--
Individuals	2,935	2,935	0
<u>Benefit Increases</u>			
Avg. Annual First Year (actual \$) <sup>1</sup>	\$1,700	\$1,700	\$0
Lifetime <sup>2</sup>	\$69.9	\$69.9	\$0.0
<u>Initial Change</u>			
Unfunded Actuarial Liability	+\$41.8	-\$5.5	-\$47.3
Funded Ratio	-0.05%	+0.01%	+0.06%
Employer Contr. Rate	+0.08%	-0.06%	-0.14%
Annual Amortized Cost <sup>3</sup>	\$5.9	-\$0.8	-\$6.7
Note: Dollars in millions, unless otherwise noted.			
1 The number of indentified individuals and the projected first year payments as provided by SERS. Does not take into account projected changes in annuitant demographics, including mortality. Eligible annuitants would only receive 50% of the value shown in the first year due to the July 1 start date.			
2 Additional retirement benefits paid over the lifetime of the annuitants and qualified beneficiaries.			
3 Analysis assumes a 10-year level dollar amortization period.			

In addition to the reduction in amortized costs, the amendment would also reduce normal costs, which are charged to employers, by \$5.2 million in fiscal year 2024-25. Total employer contributions would decrease \$11.9 million for that fiscal year compared to the costs in the base bill.

Additional notes on the impact of Amendment A01961:

- The figures in the table were generated based on the assumption that the legislation as amended would pass before November 30, 2023. If that assumption holds, no additional annual COLAs for these public officials would be authorized under current law. If the legislation as amended does not pass until after the annual deadlines for COLAs (November 30 or December 31) for these public officials, the cost savings realized by the system would decrease.
- Similarly, if the legislature were to grant pay increases in the future, those increases would offset or eliminate the savings generated by this amendment.

- SERS was only able to identify legislative and judicial members. Other elected and appointed officials (e.g., Governor, Lieutenant Governor) whose COLAs would also be eliminated under the amended legislation were not included in the analysis. Additional savings would be realized for those individuals; however, the additional impact is not expected to be material.
- As noted by Milliman, SERS' actuary assumed a 0.3% per annum salary increase for members of the legislature and judiciary to account for future promotions. Milliman notes that while this methodology may be realistic for SERS membership as a whole, it may need to be refined in the future for the classes of employees examined in this note. Milliman notes that due to the salary projections applied to legislators and the judiciary, employer contribution rates in the out years could be understated (they may be higher than projected).
- As the payroll for SERS decreases, employer contribution rates will need to increase to cover the unfunded assets of the system. The analysis projects that total contributions from all employers will be reduced 0.3% over the 30-year period; however, the employer rates, including non-legislative and judicial employers, must increase to cover the decrease in payroll.



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October 26, 2023

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Pennsylvania Independent Fiscal Office  
Second Floor  
Rachel Carson State Office Building  
400 Market Street  
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Re: Amendment A01961 to House Bill 1505, Printer's Number 1712

Dear Mr. Knittel:

As you requested, we have prepared an actuarial note on Amendment A01961 to House Bill 1505, Printer's Number 1712. This Amendment would remove the automatic cost-of-living adjustments prospectively on the compensation paid to Commonwealth public officials, such as judges and justices, Commonwealth government leaders, and members of the Pennsylvania General Assembly. The Amendment would also amend the Public Official Compensation Law to repeal the sections that provide for a cost-of-living adjustment.

The System's actuary did not provide a cost estimate for this specific Amendment, but provided an estimate for Amendment A01959 to House Bill 1415, Printer's Number 1583, which would make the same changes as this Amendment A01961. The cost estimate that was provided by the System's actuary for Amendment A01959 was combined with the cost estimate for House Bill 1415, Printer's Number 1583, which would provide increased benefits to certain retirees. That cost estimate is the basis for this actuarial note as the cost impact of Amendment A01961 would be the same as Amendment A01959 and does not depend on the bills that they are amending. As requested, this analysis provides the costs solely for Amendment A01961.

### **Executive Summary**

This Amendment would remove the automatic cost-of-living adjustments prospectively on the compensation paid to Commonwealth public officials, such as judges and justices, Commonwealth government leaders, and members of the Pennsylvania General Assembly. As most public officials participate in the State Employees' Retirement System ("SERS"), this Amendment would impact the prospective salaries, and thus the projected benefits, for legislators and judges reflected in the actuarial valuation.

Based on the SERS' actuary's projections, assuming no future cost-of-living adjustments to the compensation for legislators and judges would initially result in a decrease in the employer contribution rate in FY 2024-2025 by 0.14% and a small increase in the funded status due to the decrease in the actuarial liability for current impacted members.

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If the Amendment is enacted, the overall employer contribution rate percentage would increase in the long-term (beginning in FY 2033-2034 in the SERS' actuary's projections) and the funded status is projected to decrease slightly. Because public officials would not be receiving cost-of-living adjustments to their compensation, the overall SERS payroll would decline. As the amortization dollar payments (established by December 31, 2022) would not change but the projected payroll would be declining, the resulting accrued liability contribution rate would increase.

As directed, the cost estimate assumed no future cost-of-living adjustments would occur on impacted members' salaries and, thus, no future ad-hoc increases in public official compensation were assumed. Korn Ferry noted that "the risk associated with this assumption is that little savings may happen if future legislators or the courts make any changes that lead to different experience". **If the Amendment is enacted and future increases in compensation are provided in the future to public officials prior to their retirement, the initial savings provided by the Amendment would be reduced (or even eliminated depending on the compensation increase received).** In addition, if future salary increases are granted on an ad-hoc basis, future liabilities of SERS would increase and would then be paid by higher contributions after receipt of those increases. From an actuarial perspective, it would be better to anticipate such increases prospectively in the funding of the System.

The SERS' actuary assumed that public officials would continue to receive merit increases of 0.3% per year as there are higher paying positions that public officials (such as judges and legislators) can move into during their career. This assumption was developed based on all SERS members and we recommend that the experience study review this assumption specifically for public officials if the Amendment is enacted.

The results of the modeling can be used to understand the pattern of emerging costs and liabilities due to the proposed changes but should not be relied upon as a guarantee of actual costs to be incurred. Future funding obligations will be determined by an actuarial valuation of SERS as of the future valuation dates. Actual plan costs will ultimately be determined by the benefits provided by SERS based on actual experience of its members and not by the actuarial calculations provided for this Amendment.

Please note that not all public officials impacted by this Amendment participate in the defined benefit portion of SERS. Any savings related to other retirement plans are not reflected in SERS' actuary's nor our analysis. It is also assumed that the number of future public officials who are assumed to elect SERS participation is unaffected by this Amendment.

### **Summary of the Amendment**

This Amendment would remove the automatic cost-of-living adjustments prospectively on the compensation paid to Commonwealth public officials, such as judges and justices, Commonwealth government leaders, and members of the Pennsylvania General Assembly. Such adjustments would cease for periods beginning after December 31 (for judges, justices

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and Commonwealth government leaders) and after November 30 (for members of the Pennsylvania General Assembly) which first follows the effective date of the Amendment. The Amendment would also amend the Public Official Compensation Law to repeal the sections that provide for a cost-of-living adjustment. As a result, public officials (e.g. elected officials and appointees) would no longer receive annual salary increases related to changes in inflation.

### **Discussion of the Amendment**

This Amendment would remove the automatic cost-of-living adjustments prospectively on the compensation paid to Commonwealth public officials, such as judges and justices, Commonwealth government leaders, and members of the Pennsylvania General Assembly. As most public officials participate in SERS, this Amendment would impact the prospective salaries for legislators and judges reflected in the actuarial valuation. If this Amendment is enacted, the assumed salary increases for legislators and judges would not include an inflationary component.

This change would also impact the projected future payroll of SERS members. Because a portion of the membership would not be receiving inflationary salary increases, the total payroll in future years would be less if the Amendment is enacted. This would lead to an increase in the overall employer contribution rate percentage in the long-term (beginning in FY 2033-2034 in the SERS' actuary's projections). For amortization bases established by December 31, 2022, as the amortization dollar payments would not change but the projected payroll would be declining, the resulting accrued liability contribution rate would increase.

The change in the accrued liability due to the Amendment would be funded in equal dollar installments over a 10-year period in accordance with Section 5508(c) as the change in the accrued liability is due to legislation.

### **Review of Estimated Actuarial Cost Prepared by System Actuary**

The IFO provided us with a copy of the October 23, 2023 estimate by Korn Ferry for SERS for a similar amendment. In addition, Korn Ferry has provided us with additional details regarding their cost estimates. We appreciate their cooperation in providing this information on a timely basis.

The estimate contains the projected increase in the unfunded actuarial accrued liability, the increase in normal cost, and first year of amortization payments due to this Amendment assuming it is effective prior to November 30, 2023 along with projections of the employer contributions in dollars and in percentages of payroll, the unfunded liability and the funded status.

We have reviewed the estimate and found that the first year impact of this Amendment appears to be reasonable. For the second and later years, while we agree that the employer contribution rate would initially be reduced and then increase if the Amendment were enacted, we believe that the employer contribution rate may be understated in certain latter years of the 30-year

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projection period due to a potential understatement of the projected salary reduction as discussed below.

Due to Korn Ferry's current projection methodology, a simplified approach was used to estimate the impact of this Amendment on new Public Official entrants into SERS. We believe this simplified approach is overstating the projected future payroll in the latter years of the 30-year projection period as the simplified approach does not reflect the compound nature of salary increases. This results in an understatement of the projected employer contribution rate in certain latter years of the projection. When looking at SERS in the aggregate, the current projection methodology is reasonable, but when looking solely at legislators or judges, the methodology is not granular enough. Korn Ferry indicated that they plan to improve their projection methodology in conjunction with the next valuation. Note that legislators and judges comprise just over 1% of SERS active membership on a count basis and just over 2% on a compensation basis.

Korn Ferry's estimate reflected 1,077 active members as of December 31, 2022, who would be impacted by this Amendment – 136 legislators and 941 judges. Korn Ferry indicated that there are a small number of other active members (such as Commonwealth government leaders and legislators in Classes A5 and A6) who would be affected by the Amendment, but were not able to be identified prior to performing the analysis. They indicated that the missing group would have a de minimis impact on the results. We have not been provided the underlying data files to review the accuracy of these calculations and have relied upon them in our analysis.

As directed, the cost estimate assumed no future cost-of-living adjustments during the projection period. No future ad-hoc increases in public official compensation were assumed. Affected members were assumed to receive annual salary increases of 0.3% per year, reflecting potential promotions within the legislature and the judiciary. The 0.3% assumption was determined based on all SERS membership and not just the public officials impacted by this Amendment. We suggest that the salary increases associated with just public officials be reviewed to determine if the 0.3% assumption is reasonable and represents the best estimate for this population.

Based on this estimate for SERS, the table below contains the estimated change in the unfunded actuarial accrued liability, the change in the normal cost, and the change in the first year of amortization payments due to this Amendment assuming the Amendment was effective before November 30, 2023.



**Estimated Actuarial Cost of Amendment A01961  
 to House Bill 1505, Printer's Number 1712  
 (\$ amounts in millions)**

	Amendment A01961
Change in Unfunded Actuarial Accrued Liability (UAL) as of December 31, 2023	\$(47.3)
Change in First Year Employer Contribution	
Normal Cost	(5.2)
UAL Amortization	(6.7)
Total	(11.9)
Change in First Year Employer Contribution Rate	
Normal Cost	(0.07%)
UAL Amortization	(0.10%)
Total	(0.17%) <sup>1</sup>

<sup>1</sup> The projections provided as part of the supplemental information submission indicate that the FY 2024-2025 employer contribution rate would decrease by 0.14% of payroll versus the 0.17% shown in the table. Because the Amendment would reduce the projected payroll for FY 2024-2025, the projected employer contribution rate determined prior to the reductions in the normal cost and amortizations would increase by 0.03% of payroll.

Based on the information provided for SERS, the Amendment would result in a slight increase in the funded ratio as of December 31, 2023. The projected SERS' funded ratio as of December 31, 2023 would increase by approximately 0.06%.

If the Amendment is enacted, the overall employer contribution rate percentage would increase in the long-term (beginning in FY 2033-2034 in the SERS' actuary's projections). Because public officials would not be receiving cost-of-living adjustments to their compensation, the overall SERS payroll would decline. As the amortization dollar payments (established by December 31, 2022) would not change but the projected payroll would be declining, the resulting accrued liability contribution rate would increase resulting in contribution increases for other participating employers. The total amount of employer contribution dollars projected to be paid during the 30-year projection period would be reduced by 0.3% if the Amendment were enacted.

## **Basis for Analysis**

In performing this analysis, we have relied on the information provided by the IFO, SERS, and Korn Ferry. We have not audited or verified this data and other information. If the data or information is inaccurate or incomplete, the results of this analysis may likewise be inaccurate or incomplete.

We performed a limited review of the cost estimates prepared by Korn Ferry as provided by the IFO and SERS for reasonableness and consistency and have not found material defects. If there are material defects, it is possible that they would be uncovered by a detailed, systematic review and comparison to search for values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

Future actuarial measurements may differ significantly from the current measurements presented in this analysis due to actual plan experience deviating from the actuarial assumptions, the natural operation of the plan's actuarial cost method, and changes in plan provisions, actuarial assumptions, actuarial methods, and applicable law. An assessment of the potential range and cost effect of such differences is beyond the scope of this analysis.

As the reviewing actuary, Milliman is not required to provide a risk disclosure under Actuarial Standard of Practice No. 51 *Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions* nor the additional disclosures required for funding valuations under Actuarial Standard of Practice No. 4 *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*.

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- The IFO may provide a copy of Milliman's work, in its entirety, any applicable regulatory or governmental agency, as required by law.

No third party recipient of Milliman's work product should rely upon Milliman's work product. Such recipients should engage qualified professionals for advice appropriate to their own specific needs.

The consultants who worked on this assignment are actuaries. We have not explored any legal issues with respect to the proposed changes. We are not attorneys and cannot give legal advice on such issues. We suggest that you review this proposal with counsel.

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Mr. Matthew Knittel  
Pennsylvania Independent Fiscal Office  
October 26, 2023  
Page 7

We are members of the American Academy of Actuaries and meet its Qualification Standards to render this actuarial opinion.

Please let us know if we can provide any additional information regarding this Amendment.

Sincerely,

A handwritten signature in black ink that reads "Timothy J. Nugent".

Timothy J. Nugent

A handwritten signature in black ink that reads "Scott F. Porter".

Scott F. Porter

A handwritten signature in blue ink that reads "Katherine A. Warren".

Katherine A. Warren

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