SB 1071 (PN 1481)

As amended by #A08206

Overview of Proposal:

- **New Plan Design:** Places future (new) hires in a newly created "stacked" hybrid (DB/DC) retirement plan. The plan design features a traditional defined benefit pension on a limited salary base below a "threshold", with a defined contribution plan applying to the salary above the threshold.
    - DB component would earn benefits at a 2 percent accrual rate.
    - The salary threshold would start at $50,000 and be indexed by 3 percent annually.
        - Exempts State Police only. State Police do not participate in Social Security. The DiLauro award still applies for PSP members accruing 20 or more years of service.
        - Future judges would be in the plan, however it would be expected that this aspect of the proposal could be challenged in court as an infringement of a unified judicial system.
- **Reduces Benefits:** The benefit for future employees (the combined DB and DC benefit) is reduced by roughly 25 to 40 percent. In 2010, Act 120 reduced benefits by 20 percent. Lower salaried workers whose salary remains below the threshold will be impacted minimally.
- **Creates a 401(k):** Reduces retirement benefits and adds a 401(k)-style component to the retirement plan. Satisfies the Republican majority's requirement that a portion of an employee's retirement benefit be funded in part with a defined contribution benefit. The current plan does not optimize the DC component of the plan because the participants do not start accumulating assets in the DC until later in their career.
- **Complicated.** Pension experts have indicated that this would be one of the more complicated plan designs in the country.

Key Takeaways:

- **Unfunded Liability:** The proposal will not pay down the unfunded liability any faster than the status quo (Act 120).
- **Long-Term Savings:** All savings are generated from cuts to benefits and is estimated to save $6 billion over 32 years on a cash flow basis. It will take approximately 20 years to save $1 billion on a cash flow basis.
- **Short-Term Budget:** The proposal will generate $11 million budgetary savings for the state in 2018, however will have immediate, up-front administrative costs of roughly $19 million ($7 million PSERS and $12 million for SERS) and second year costs of $9 million ($5 million PSERS and $4 million SERS). School Districts will not begin to see savings until 2019, and the amount saved statewide will be roughly $3 to $5 million.
- **Benefit Reduced:**
    - <u>Compared to the Current Act 120 Benefit:</u> The proposed plan would provide a benefit for PSERS' members that is 74 percent of the current Act 120 benefit and would provide a benefit for SERS' members that is roughly 70 percent of the Act 120 benefit, or more depending on how much of a workers' salary is below the threshold. These figures reflect estimates prepared by each systems' actuaries using conservative assumptions as determined by each systems' Boards or as suggested by their actuaries.
    - <u>Pre-Retirement Replacement Income:</u> Not including Social Security, the plan will provide a replacement income of 40 to 50 percent for school employees and 36 to 57 percent for state employees. A target replacement rate is roughly between 75 and 80 percent of pre-retirement income levels.
- **Constitutional Implications:** Current members are not impacted thus contract impairment issues are unlikely to be a major issue.
- **School District Administration Costs:** It is expected that each school district will incur significant up-front costs to implement the changes, but have not yet been estimated.

Plan Details:

- **Effective 2018:** January 1 for SERS; July 1 for PSERS.
- Under the **defined benefit (DB) component**, the benefit formula would be equivalent to the 2 percent benefit accrual rates multiplied by the worker's years of service (maximum 25 years), multiplied by the worker's final average salary (highest five years), with an annual pay limit equal to that of the threshold, annually indexed by 3 percent.
- Under the **defined contribution (DC) component** workers would contribute 1.5 percent of salary under the threshold and 7.5 percent of salary for earnings above the threshold. Employers would contribute 0.5 percent of salary under the threshold and 4 percent of salary on earnings above the threshold.
- **Employee & Employer Contribution Rates:**

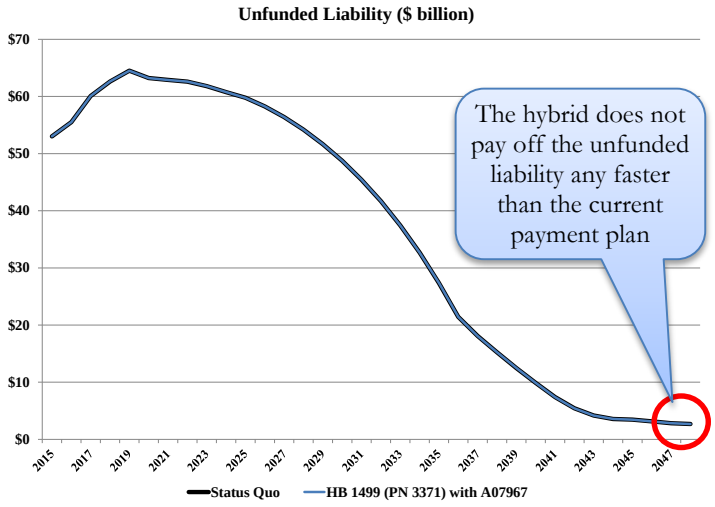
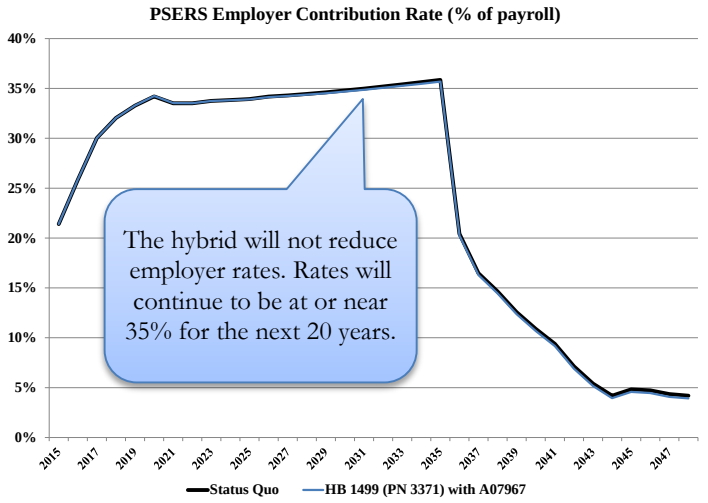
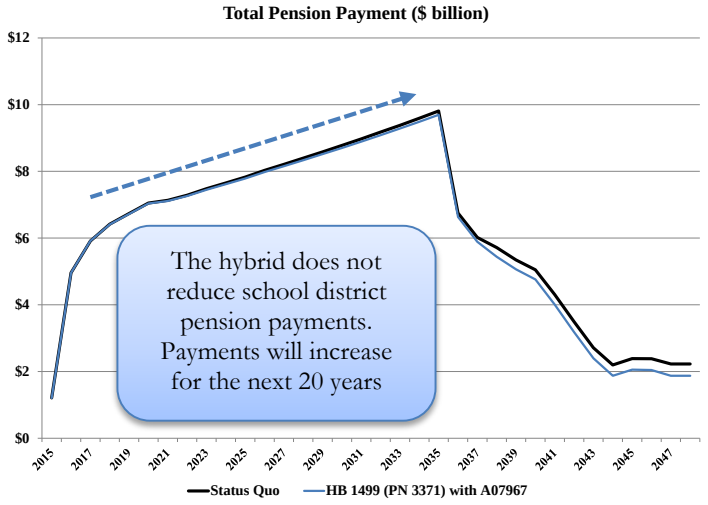
Employee & Employer Contribution Rates, as a percent of salary								
Earnings	**Under 25 Years of Service**				**Over 25 Years of Service**			
	Component	Employee	Employer	Total	Component	Employee	Employer	Total
Below Threshold	**DB** **DC** **Total**	**6.0%** **1.5%** **7.5%**	**<2.0%** **0.5%** **<2.5%**	**<8.0%** **2.0%** **<10%**	**DB** **DC**	**--** **7.5%**	**--** **4.0%**	**--** **11.5%**
Above Threshold	**DB** **DC**	**--** **7.5%**	**--** **4.0%**	**--** **11.5%**	**DB** **DC**	**--** **7.5%**	**--** **4.0%**	**--** **11.5%**

Please note that the current employee contribution rate for PSERS members is 7.5% and for most SERS members the rate is 6.25%.

- **Other Provisions:**

Retirement Age	No change.
Vesting	Defined Benefit Component: 10 years Defined Contribution Component: 3 years for the employer contribution and immediately for employee contributions
Final Average Salary	Calculated using five years of salary including overtime. PSP overtime compensation is capped at 10% of salary when calculating the member's annuity.
PSERS' Healthcare Premium Assistance	No change.
Benefit Lock-up	Permit employees to receive a benefit on an actuarially neutral basis.
Shared Risk	Same as Act 120 shared-risk provisions, however with a maximum rate of 8%.
Early-Out Provision	No change (PSERS only).
Footprint Rule	If there is a break in service, current members would retain their pre-reform benefit.
Independent Legal Counsel	Permits the legal counsel to the systems' boards shall to serve independently from the Governor's Office of General Counsel, the Attorney General and the General Assembly.
Legislative Rights Reserved	Limits this provision to include language complying with IRS requirements to maintain tax-deferred status.
Investment Restrictions	The provisions in the bill constrain the systems' independent boards from optimizing benefits offered to its members. This provision could add layers of duplicative or unnecessary fees.
Higher Education	May continue to offer TIAA-CREF as an option to its employees.

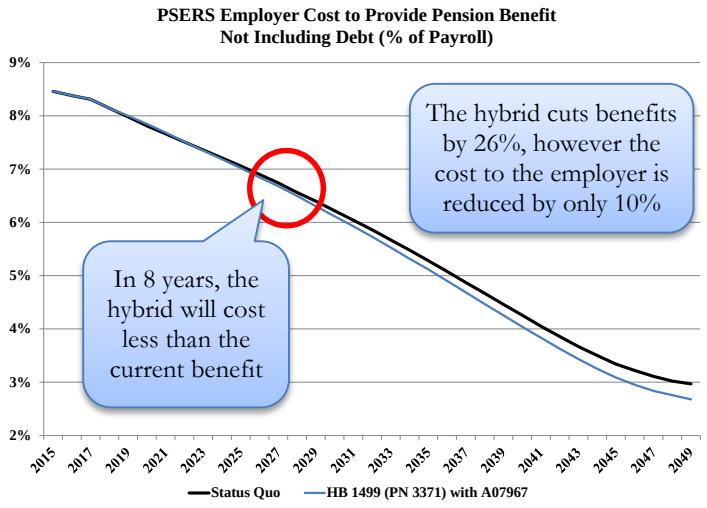
Useful Performance Metrics to Assess the Impact of a Pension Plan vs. Status Quo

Performance Metric	Chart
The **Unfunded Liability** is the difference between assets and liabilities. Roughly 70 percent of the employer payment is used to pay down the pension debt.	
The **employer contribution rate** is calculated by actuaries and includes the cost of the benefit plus the cost of the unfunded liability. School districts' employer contribution rates are expected to level-out at roughly 34 percent of payroll beginning in 2018 and remain at this level for approximately 20 years until the debt (principal and interest) is largely amortized.	
The **total employer payment** is the projected dollar amount that employers must pay per year. In either case, going with the status quo or with a stacked hybrid plan, the total pension payment made by all of PSERS' employers will increase for the next 20 years from $5 billion (2016) to about $9.5 billion (2035). For the next 25 years, districts will pay more than they pay today - in terms of dollars spent.	

Performance Metric	Chart

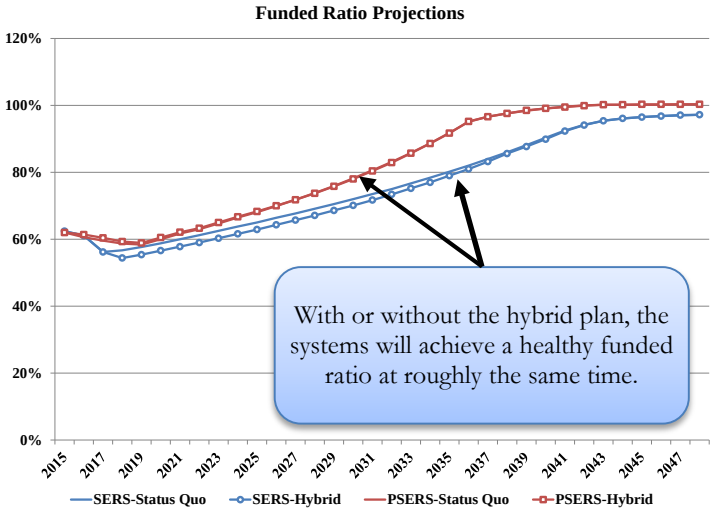
The **employer cost** to provide pension benefits is calculated by actuaries and is the cost today to provide an earned pension benefit in the future. Also called the "employer normal cost".

The cost for PSERS' employers, the school districts, to provide a pension benefit for its employees (i.e. the normal cost), is less than 3 percent (2.97 percent). The proposed stacked hybrid plan cost to provide a benefit will be 2.68 percent, which is a cost reduction of 10 percent.



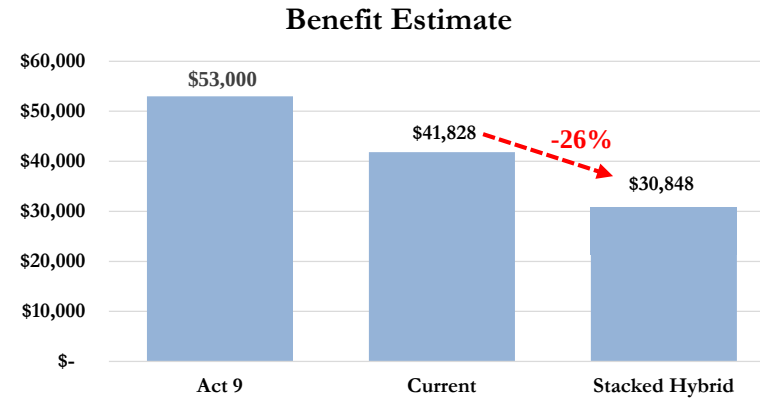
Expressed as a percentage of a system's liabilities, the **funded ratio** is calculated by dividing assets by its liabilities. A ratio above 80 percent is considered "healthy" for state government pension plans which operate in perpetuity. Compared to private companies (which can be dissolved at any time) that have pension plans, ERISA requires any shortfall be paid off in 7 years.

As is shown in the chart to the right, both systems will achieve an 80 percent funded ratio the same time with no reform as it would with the hybrid plan.



The **estimated benefit** provides a calculated estimate of what a typical employee benefit will be under the hybrid plan relative to a comparable benefit being currently earned.

The **replacement rate** is a term that is used to provide a number to help individuals plan for retirement and is expressed as a percentage that is calculated by dividing the estimated pension benefit by their pre-retirement income. A target replacement rate is roughly between 75-80 percent. The replacement rates shown do not include Social Security.



Replacement Rate:	86%	68%	50%

Example: PSERS member with 35 years of service and a final average salary of $62,000.