Overview of the Impact of Act 2010-120 on the Public School Employees' Retirement System (PSERS)

Act 120: Overview

- **At a high level, Act 120 makes the following changes to the Public School Employees' Retirement Code, 24 Pa.C.S. §8101 *et seq.*:**
  - **A series of prospective benefits reductions**
    - **The benefits changes in Act 120 only apply to new employees who become new members of PSERS on or after July 1, 2011**
    - **Any existing or former members of PSERS who return to service on or after July 1, 2011 will retain their old membership status**

Act 120: Overview

- Increased funding of PSERS through controlled employer contribution rate increases
- Changes to PSERS actuarial funding methodology to moderate the rise in PSERS' employer contribution rate and reduce its future volatility
- A series of administrative changes that impact the operations of PSERS

Act 120:
Prospective Benefit Reductions*

- Act 120 creates two new classes of PSERS members known as TE and TF
- The key class TE member benefits are as follows:
  - The pension multiplier is 2% instead of 2.5% for current TD members
  - Vesting is 10 years instead of 5 years for current TC and TD members
  - The TE member's minimum employee contribution rate remains at 7.5% of the employee's compensation; the same as current TD members
  - Unlike TC and TD members, TE members cannot withdraw their employee contributions and interest at retirement
  - To receive an unreduced pension, TE members will need to work until age 65 with 3 years of service or any age/service combination that totals 92 ("Rule of 92") with a minimum of 35 years of service

***The benefits changes in Act 120 only apply to new employees who become new members of PSERS on or after July 1, 2011. Any existing or former members of PSERS who return to service on or after July 1, 2011 will retain their old membership status.**

Act 120:
Prospective Benefit Reductions*

- **The key class TF member benefits are as follows:**
  - The pension multiplier is 2.5%, the same as that for current TD members
  - Vesting is 10 years instead of 5 years for current TC and TD members
  - The TF member's minimum employee contribution rate increases to 10.3% of the employee's compensation compared to 7.5% for current TD members
  - Unlike TC and TD members, TF members cannot withdraw their employee contributions and interest
  - To receive an unreduced pension, TF members will need to work until age 65 with 3 years of service or any age/service combination that totals 92 ("Rule of 92") with at least a minimum of 35 years of service

***The benefits changes in Act 120 only apply to new employees who become new members of PSERS on or after July 1, 2011. Any existing or former members of PSERS who return to service on or after July 1, 2011 will retain their old membership status.**

Act 120: Prospective Benefit Reductions*

- Both TE and TF members' employee contribution rates are subject to change every three years beginning on July 1, 2015, as a result of the new shared risk provisions outlined on slides 10-11
- On or after July 1, 2011 new members of PSERS will automatically default into class TE but will have 45 days after notification by PSERS to elect class TF membership
- Other changes:
  - A TE and TF member's pension benefit is limited to not more than 100% of his or her final average salary
  - A TE and TF member will pay the full actuarial cost to purchase most non-state/non-school service, including non-qualifying service

***The benefits changes in Act 120 only apply to new employees who become new members of PSERS on or after July 1, 2011. Any existing or former members of PSERS who return to service on or after July 1, 2011 will retain their old membership status.**

Act 120: Increased Funding

- Act 120 makes use of rate caps to moderate the rise of PSERS' annual employer contribution rate
  - The rate caps will limit the amount that the pension component of PSERS' employer contribution rate can increase over the prior year's rate as follows:
    - For FY 2011-12, not more than 3.0%
      - Since the pension component of FY 2010-2011's employer contribution rate is 5%, for FY 2011-12 the pension component cannot exceed 8%, plus the amount needed to fund premium assistance, which is currently projected to be .65%
    - For FY 2012-13, not more than 3.5%
    - For FY 2013-14, not more than 4.5%
    - For every year thereafter not more than 4.5%

Act 120: Increased Funding

- The rate caps remain in effect until the caps no longer apply, i.e. the rise in the employer contribution rate as determined by PSERS' actuary is less than the cap in effect at that time
- After that, the employer contribution rate will be the rate calculated by PSERS' actuary and approved by the PSERS' Board, subject to a new rate floor or minimum employer contribution rate that will be the employer normal cost (currently about 8%), plus the amount required to fund premium assistance

Act 120: Increased Funding

Shared Risk Provisions:

- Commencing with the annual actuarial valuation ending June 30, 2014 and every 3 years thereafter, PSERS will compare the actual investment rate of return, net of fees, to the actuarial assumed rate of return for the previous 10 year period
- If the actual investment rate is less than the assumed rate by 1% or more, the total member contribution rates for both TE and TF members will increase by .5%
- If the actual investment rate is equal to or more than the assumed rate, the total member contribution rate for both TE and TF members will decrease by .5%

Act 120: Increased Funding

- The total member contribution rate for TE members shall not drop below 7.5% nor go above 9.5%
- The total member contribution rate for TF members shall not drop below 10.3% nor go above 12.3%
- New members on or after July 1, 2011 will contribute at the rate in effect when they are hired
- The shared risk contributions will be used to reduce PSERS' unfunded accrued liability created by investment underperformance
- If PSERS is fully funded at the time of the comparison, then the shared risk rate will be zero for that period, leaving the member rate at either 7.5% for TE members or 10.3% for TF members, i.e. the base rates
- If the Commonwealth does not contribute the rate specified by PSERS' actuary, the TE and TF members' contribution rates return to the base rates
- Until a full 10 year look back period is available, the look back period will begin as of July 1, 2011

Act 120: Actuarial Changes

- Effective with PSERS' June 30, 2010 actuarial valuation, level percent of pay amortization will be used instead of the current level dollar amortization method
  - Under a level percent of pay amortization method, the amortization payment is calculated using the same percentage of compensation each year during the amortization period
  - Since compensation is assumed to increase each year, the actual dollar amount of the amortization payment will increase each year
  - Under a level dollar amortization, the annual dollar amount of the payment remains the same each year

Act 120: Actuarial Changes

- Effective with PSERS' June 30, 2010 actuarial valuation, 10 year asset smoothing will be used instead of the current 5 year asset smoothing period
  - "Smoothing" is the period over which actuarial gains and losses are recognized by PSERS
- Effective with PSERS' June 30, 2010 actuarial valuation, all unfunded actuarial accrued liabilities will be re-amortized over a 24 year period at level percent of pay, instead of the current 30 year period
- Funding of any future, legislatively enacted increases in accrued liability, such as cost of living increases, will be amortized over a 10 year period, using the level percent of pay method and the cost of the additional accrued liability must be reflected above the employer contribution rate caps established by Act 120

Act 120: Administrative Changes

- Eliminates the requirement for annual qualification (500 hours or 80 days for hourly and per diem employees) by a member (both existing and new), to accrue retirement credit
  - Subsequent to initial qualification all service earned thereafter is qualified service provided the member remains in service
  - If the member terminates membership and then subsequently returns to service the former member would need to again qualify for membership
- Creates a three year window beginning July 1, 2011, for then current active members to purchase Non-qualifying Part-Time service (NQPT)
  - New TE, TF and returning TC and TD members who become active after July 1, 2011, will have a one year window to purchase their NQPT

Act 120: Administrative Changes

- Implementation date of key provisions of Act 120 is generally July 1, 2011
- The use of pension obligation bonds to fund PSERS is prohibited
- PSERS shall not project service for TE and TF members to determine their superannuation age
- School entities must make the full employer contribution rate payment to PSERS even if they do not receive the Commonwealth's share, if the failure to receive the Commonwealth's share is a result of delinquent salary reporting or other conduct by the school entities
- Independent Fiscal Office (IFO) Study
  - The IFO, (which was created by the Act), shall study and analyze the implementation of the shared risk provisions of Act 120
  - The study shall be completed by December 15, 2015

Questions?