December 17, 2015

PSBA Summary of Pension Reform Proposals in Senate Bill 1071, PN 1475

Senate Bill 1071 amends Title 24 of the Consolidated Statutes (Education) relating to the Public School Employees' Retirement Code and Title 71 (State Government) relating to the State Employees' Retirement Code. Starting July 1, 2017 for new PSERS members and January 1, 2018 for new SERS members, new employees would be placed in a new side-by-side hybrid retirement plan with a reduced defined benefit component (as compared to current employees) and a defined contribution component operating similarly to a 401(k) plan. In addition, the bill would subject current PSERS employees to shared risk/shared gain employee contribution rate adjustments, and would change how the lump sum withdrawal option affects the calculation of annuities for current PSERS employees with regard to withdrawals made after July 1, 2016 of amounts accumulated after July 1, 2016.

SB 1071 replaces SB 1082 as the pension reform bill most likely to move forward. Nearly all provisions of SB 1071 are identical to what appeared in SB 1082. The two differences of substantive note for the PSERS system are that SB 1071 does not provide for a 2.25% employer contribution rate collar for fiscal year 2016-2017 as did SB 1082, and SB 1071 would add an option for current employees to elect to become members of the new class of service created for new employees, class T-G.

The specific changes pertinent to school employees and employers in the PSERS system are summarized below.

Defined benefit component for new school employees

- New school employees starting on or after July 1, 2017 would be placed in new class of PSERS service "T-G".
- Class T-G employee basic contribution rate would be 4%.
- The benefit accrual rate would be 1% of final average salary per year of service.
- Benefits would vest after 5 years.
- Final average salary would be calculated based on the last 5 years of service, without any anti-spiking provisions.
- Superannuation age for full retirement would be age 65, or any age if age combined with years of service (at least 35) would equal 92.
- "Shared-risk/shared-gain" adjustments to the employee contribution rate would be made based on investment performance of the fund. The adjustments would be calculated every 3 years based on comparison of the actual rate of investment return for the prior ten-year period with the assumed rate of return (the interest rate adopted by the board) for the same period.
- Shared risk adjustments would occur as follows:
    - If the actual rate of return falls short of the assumed rate (adopted annual interest rate) by less than 1% or is equal to the assumed rate, AND the employee contribution rate is already below the basic contribution rate (due to previous shared gain reduction), the shared risk rate increases by .5%.

  - If the actual rate of return falls short of the assumed rate by 1% or more, the shared risk rate goes up by .5% even if the current employee contribution rate is NOT already below the basic rate.
- Shared gain adjustments would occur as follows:
  - If the actual rate of return exceeds the assumed rate by less than 1%, or is equal to it, AND the employee contribution rate is already above the basic rate (due to a previous shared risk increase), the shared risk rate goes down by .5%.
  - If the actual rate of return exceeds the assumed rate by 1% or more, the shared risk rate goes down by .5% even if the current employee contribution rate is NOT already above the basic rate.
- Other shared risk-shared gain limits are:
  - Regardless of investment performance, the total class T-G employee contribution rate would not be less than 2% nor more than 6%.
  - If the system's actuarial funded status is 100% or more, the shared risk rate cannot be greater than zero.
  - If in any year the employer rate is artificially set at less than the actuarially determined final contribution rate, employee total contribution rates are reset to the basic contribution rate going forward.
  - There can be no increase in the employee contribution rate if there has not been at least an equivalent increase in the employer contribution rate over the previous three year period.
- Class T-G members would be eligible to elect "Option 4" lump sum payments upon retirement not exceeding their total accumulated deductions and interest, with an actuarially equivalent reduction in their annuity.
- Class T-G annuitants would be eligible to participate in the Health Insurance Premium Assistance program and Health Options health insurance programs.

Defined contribution component for new school employees in PSERS

- New employees in PSERS class T-G would also be mandatory participants in a defined contribution plan to be known as the "School Employees Defined Contribution Plan".
- The mandatory employee defined contribution rate would be 3.5%, which would be treated as a "pickup" contributions the amount of which for governmental plans is not included in income that is subject to FICA and Social Security withholdings.
- Employees would have the option of making voluntary additional tax-deferred contributions up to limits set by the Internal Revenue Code, but which would be treated as income subject to FICA and Social Security withholdings.
- The mandatory employer defined contribution rate would be 2.5%.
- Each employee has an individual, separately accounted-for defined contribution investment account.
- Employees are vested in their own contributions immediately and in the employer contributions once they have completed three years of service.
- The same PSERS board of trustees that governs the defined benefit plan would also be the governing body responsible for the defined contribution plan.
- The board would have the authority to adopt rules under which employees in other classes of service who are not mandatory DC participants could participate in the DC plan on a voluntary basis.

Shared risk-shared gain provisions affecting current employees

- All current employees would become subject to the same shared risk and shared gain mechanisms as new employees, except for different minimum and maximum total contribution rates based on the basic contribution rate applicable to each class of service, as follows:

- Class T-C with current basic rate of 6.25 – minimum 4.25%; maximum 8.25%
- Class T-D with current basic rate of 7.5% - minimum 5.5%; maximum 9.5%
- Class T-D with current basic rate of 6.5% - minimum 4.5%; maximum 8.5%
- Class T-E with current basic rate of 7.5% - minimum 5.5%; maximum 9.5%
- Class T-F with current basic rate of 10.3% - minimum 8.3%; maximum 12.3%

- The effect for each class of service is that regardless of system investment performance, the employee total contribution rate cannot increase or decrease from the regular employee contribution requirement by more than 2% above or below the basic contribution rate for that class of service.
- Currently, only employees in classes T-E and T-F are subject to the shared risk provisions, and there are no shared-gain provisions that would lower rates below basic contribution rates. Employees in classes T-C and T-D are not currently subject to the existing shared risk provisions.

Actuarially neutral lump-sum withdrawal calculations for current and new employees

- Reduced annuities for all retiring members electing to receive "Option 4" lump sum payments (which cannot exceed the total amount of the member's accumulated deductions and interest) on or after July 1, 2016 must be calculated so as to be actuarially neutral.
- Currently, employees in classes T-E and T-F are not eligible to elect Option 4 lump sum payments, but under SB 1071 would become eligible to do so on the same basis as new employees in class T-G.
- For employees in classes T-C and T-D, the change in calculation methodology does not apply to lump payments made prior to July 1, 2016 nor to payments after July 1, 2016 to the extent they are attributable to deductions and interest that were accumulated prior to July 1, 2016.

Option for current employees to elect to become class T-G members

- SB 1071 would give current employees the option to elect to become members of class T-G, subject to all provisions applicable to new school employees, and thus also mandatory participants in the defined contribution plan.
- The election to opt into class T-G would have to be made by current active employees no later than June 30, 2017 or their date of termination of service, whichever is earlier.
- Former employees of other classes who return to service on or after July 1, 2017 would have 45 days to make the election.
- The election to opt into class T-G would be irrevocable.
- Employees who do not make a timely election would lose the option permanently.

Employer funding mandate provisions

- SB 1071 adds provisions giving employees a contractual entitlement to employer funding of the system, enforceable in court.
- If employers fail to timely pay what is actuarially required in order to adequately fund the system, employees may sue their employers to enforce the guarantee, and can recover attorney fees in addition to other relief.
- The Pa. Supreme Court has exclusive jurisdiction to hear such cases.
- PSBA has recommended language be added to these provisions ensuring that local school employers are not exposed to such liability when legislation has set an employer contribution rate artificially below the actuarially determined rate and the employer has paid into the system everything required or allowed by law under such legislation.

Potential new requirements for administration of local 403(b) and 457 plans

- PSBA has identified stray provisions included in SB 1071 that PSBA believes to have been inadvertently carried over from earlier pension reform proposals in Senate Bill 1 of 2015, which if not removed could be construed to impose new requirements for the administration of 403(b) or 457 deferred income retirement plans offered by local school employers for their employees. In SB 1, these provisions were tied to another section addressing matters that are not a part of what SB 1071 now proposes.
- PSBA has recommended that these stray provisions be removed from the bill. Otherwise, they could be construed to require school districts offering 403(b) or 457 plans to contract with no less than four different financial or pension management organizations to offer services in connection with the plans.

Composition of PSERS Board of Trustees

- The Secretary of Banking and Securities would be added as an ex officio member of the PSERS board.
- Any current member of the General Assembly on the board, and the board members elected by and representing active employee members and active retiree annuitants, would be prohibited from serving as the chairperson of the board.