INDEPENDENT FISCAL OFFICE

August 13, 2018

The Honorable Patrick M. Browne
Chair, Appropriations Committee
Senate of Pennsylvania
281 Main Capitol Building
Harrisburg, PA 17120

Re: Requested Actuarial Note House Bill 1460, Printer's Number 3626

Dear Senator Browne:

I am writing in response to your request concerning an actuarial note for House Bill 1460, Printer's Number 3626. The legislation would amend the Public School Employees' Retirement Code (24 Pa.C.S.) and the State Employees' Retirement Code (71 Pa.C.S.) to (1) make technical corrections to certain sections added or amended by Act 5 of 2017, (2) add provisions for nonparticipating employer withdrawal liability under the Public School Employees' Retirement Code and (3) require the boards of the Public School Employees' Retirement System (PSERS) and the State Employees' Retirement System (SERS) to publish certain financial information on their public websites within six months after the end of each system's fiscal year.

The technical corrections pertaining to the Public School Employees' Retirement Code are summarized below. The legislation clarifies that:

- Class DC participants are eligible for premium assistance. The provisions also address how Class DC members earn eligibility points.
- Only Class DC participants who are receiving distributions are eligible to vote for the annuitant member of the board.
- The interest rate applicable to delinquent employer contributions applies to the current fiscal year.
- There will be one overall employer contribution rate to be charged against the entire payroll.
- Non-vested contributions that are forfeited may be retained by the board and used for the payment of expenses of the plan.

The legislation amends the Public School Employees Retirement Code to add new provisions regarding nonparticipating employer withdrawal liability. The provisions would authorize the PSERS board to determine if an employer is a nonparticipating employer, and if so determined, to establish the employer's withdrawal liability amount to be paid to the system. Additional details and discussion regarding this provision are included in the enclosed actuarial note prepared by Milliman, the consulting actuary for the Independent Fiscal Office (IFO).

The legislation also amends the State Employees' Retirement Code to clarify that the board may adjust member contributions for members who elect to become members of Class A-6. In addition, the legislation removes unnecessary language regarding the eligibility for death benefits and corrects a cross-reference regarding the early retirement factor applicable to Class A-5 and Class A-6 service.

Under the legislation, reporting requirements would be added to require the boards of PSERS and SERS to publish the following information to the extent it is reasonably available: (1) the performance of investments over the most recent 1-, 3-, 5-, 10- and 20-year periods, (2) the performance of all investments by asset class over each time horizon both gross and net of fees commencing prospectively, with the gross fees reported retroactively for the 5-year period and (3) a detailed listing of the fees paid to investment managers for the applicable reporting years. The fee reporting requirements must be based on industry-approved valuations and informed by the practices recommended by the Institutional Limited Partnership Association Fee Transparency Initiative, which provides comprehensive guidance and industry standards for fee and expense reporting among institutional investors and fund managers. The material to be published would supplement the annual financial statements currently required by statute. Publication would not be required if it is prohibited by a contract that is in effect on the effective date of the amendments.

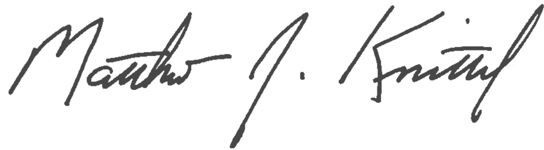
Under section 615-B of the Administrative Code of 1929, the IFO has the responsibility to review legislative changes that may affect public employee pension or retirement plans and to provide actuarial notes for such legislation. The IFO's consulting actuary evaluated (1) the technical corrections and (2) the addition of nonparticipating employer withdrawal liability contained in House Bill 1460, Printer's Number 3626 and determined that those provisions would have no actuarial cost impact on either PSERS or SERS. The IFO evaluated the new reporting requirements for PSERS and SERS in that legislation and determined that the provisions would have no actuarial cost impact.

Based on the determinations of the IFO and its consulting actuary, the legislation will not require additional actuarial work prior to consideration by the General Assembly. The office

reviewed the legislation for actuarial cost impact, but it has not reviewed the provisions for legal, administrative or policy implications.

I trust this letter adequately responds to your request. If I may be of any further assistance, please feel free to contact me at (717) 230-8293.

Sincerely,



Matthew J. Knittel
Director, Independent Fiscal Office

Enclosure

cc: Governor Tom Wolf
Members of the General Assembly

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August 9, 2018

Mr. Matthew Knittel
Director
Pennsylvania Independent Fiscal Office
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400 Market Street
Harrisburg, PA 17105

Re: House Bill 1460, Printer's Number 3626

Dear Mr. Knittel:

As requested, we have prepared an actuarial note on House Bill 1460, Printer's Number 3626 (Bill). The Bill would amend both the Public School Employees' Retirement Code and the State Employees' Retirement Code to (i) provide for certain technical corrections to Act 5 of 2017, (ii) add a nonparticipating employer withdrawal liability for the Public School Employees' Retirement System (PSERS), and (iii) add additional reporting requirements regarding investment performance and fees. This actuarial note addresses the first two items.

Certain Technical Corrections to Act 5 of 2017

Sections 1, 3, 5, 6, and 7 of the Bill make technical corrections to Act 5 of 2017. We have reviewed the changes in these sections and have determined such changes would not have had an impact on the costs shown in our June 2, 2017 actuarial note on Amendment A01354 to Senate Bill 1, Printer's Number 853 (which became Act 5 of 2017). As such, these changes would not have an actuarial impact on the projected costs for PSERS or the State Employee's Retirement System.

Nonparticipating Employer Withdrawal Liability

Summary

Section 2 of the Bill would add §8327.1 Nonparticipating Employer Withdrawal Liability, which would enable the PSERS Board the ability to determine if an employer is a

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nonparticipating employer and, if so determined, to determine the employer's withdrawal liability amount to be paid to the System.

An employer could be found to be non-participating by having ceased either (1) covered operations or (2) to have an obligation to contribute to PSERS for all or any of the employer's school employees but continues covered operations.

The withdrawal liability amount would be based on the last actuarial valuation adopted by the Board prior to the employer's nonparticipation date. It would equal an unfunded liability multiplied by the ratio of the liability for all active members of the employer over the liability for all active members of PSERS. The unfunded liability and the ratio liability used in the calculation would depend on whether the employer has ceased covered operations or not.

If the employer has ceased covered operations, the unfunded liability (if any) equals the present value of vested accrued benefits of all members less the market value of assets. The ratio liability used to adjust the unfunded liability would be the present value of accrued benefits. The present value amounts would be determined using the same assumptions in the last actuarial valuation except that the interest rate assumption would be reduced by an "amount determined by the actuary to reflect the increased investment, mortality and other actuarial risk associated with the accrued benefit of the members of the nonparticipating employer on a basis approved by the Board."

If the employer has not ceased covered operations, the unfunded liability (if any) equals the actuarial accrued liability less the market value of assets. The ratio liability used to adjust the unfunded liability would be the present value of accrued benefits. The actuarial accrued liability and the present value of accrued benefits would be determined using the same assumptions, including interest rate assumption, in the last actuarial valuation.

The withdrawal liability for an employer who has ceased operations would be payable as a lump sum to PSERS no later than the time prescribed by the Board. The withdrawal liability for an employer who has not ceased operations would be payable based on a schedule and method of payment determined by the Board.

Discussion

This provision provides that, if an employer is determined to be nonparticipating by the Board, then PSERS would be "made whole" with a withdrawal liability payment from the withdrawing employer. Under the current funding policy of PSERS, any unfunded liability due to the withdrawing employer's members would be spread among the remaining

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employers in the System. This provision is intended to prevent increases in costs to the remaining employers due to the withdrawing employer.

Examples of an employer ceasing covered operations include charter schools that go out of business or an employer that exits the System and current employees would no longer earn future PSERS benefits through legislative or other action. These employers would be required to pay their share of the unfunded vested accrued benefits, determined using a lower interest rate assumption to account for the risk the System is taking on as no further contributions would be made by the non-participating employer.

An example of an employer that does not cease covered operations would be an entity that has all future employees join a retirement plan other than PSERS, but current employees remain PSERS members for future service. PSERS indicated this would typically be triggered by a legislative or employer action. Future contributions would be required by the employer on behalf of the current employees remaining in PSERS but those contributions would decline over time as the number of employees participating in PSERS decline. As future employees would not be in PSERS, these employers would be required to make an additional contribution for their portion of the unfunded actuarial accrued liability.

To administer the provision, the Board would need to do the following:

- Define the determination of the present value of accrued benefits, especially for ancillary death and disability benefits
- Define the determination of the present value of vested accrued benefits, especially for subsidized early retirement, death and disability benefits
- Determine the interest rate to be used in situations where an employer has ceased operations, in conjunction with the System actuary

We recommend that the annual valuation report include exhibits providing this information in total.

A number of issues could arise while applying this provision:

- Would PSERS actually be able to collect the assessment from the employer due to bankruptcy or other issues?
- Employers may challenge the withdrawal liability assessment and raise legal challenges.
- Employers who cease covered operations may challenge the interest rate assumption used.
- The ability of the PSERS Board to monitor employers with a declining workforce to determine if and when they become nonparticipating to ensure the proper

withdrawal liability is assessed. For example, if an employer terminates all but a few employees necessary to wind-up operations just prior to June 30 (the valuation date), would the Board be able to determine if such employer is nonparticipating and assess the employer's withdrawal liability amount prior to that June 30 valuation report's adoption.

Actuarial Cost

This section of the Bill would not have changed the costs shown in our June 2, 2017 actuarial note on Amendment A01354 to Senate Bill 1, Printer's Number 853 (which became Act 5 of 2017) as no employers were assumed to exit.

Basis for Analysis

In performing this analysis, we have relied on the information (both written and oral) provided by the IFO and PSERS. 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.

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.

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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.

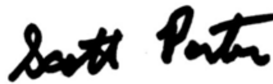
The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to the proposed plan changes. We are not attorneys and cannot give legal advice on such issues. We suggest that you review this proposal with counsel.

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 Bill.

Sincerely,

Timothy J. Nugent



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