Background for the Pension Debate

presented to the

Town Hall Meeting on Pension Reform

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Independent Fiscal Office

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Today's Discussion

➢ Role of the Independent Fiscal Office.

➢ Snapshots of the major state pension plans:
  - State Employees' Retirement System (SERS).
  - Public School Employees' Retirement System (PSERS).

➢ Useful terms in the pension debate:
  - Defined benefit plans.
  - Act 120, rate collars and annual required contribution (ARC).
  - Unfunded accrued liabilities (UAL).

➢ Size of the unfunded liabilities – history & projections.

➢ Employer contribution rates.

➢ General Fund pension projections.

Independent Fiscal Office

➤ The Independent Fiscal Office (IFO) is a nonpartisan, independent agency that provides analysis of fiscal, economic and budgetary issues.

➤ The IFO does not take positions on issues, proposals or policies.

➤ Our role tonight is to provide general data and background.

- With the exception of making five-year projections of General Fund appropriations under current law, the office has not performed its own analysis of pension funding.

- Data in this presentation generally are derived from the comprehensive annual financial reports, actuarial valuations and budget materials published by SERS and PSERS.

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SERS and PSERS Snapshot

	SERS[1]	PSERS[2]
Members (active, inactive & retired)	231,633	609,776
Fund Assets	$27.4 billion	$53.3 billion
10-Year Average Funding Sources	13% member 12% employer 75% investments	17% member 16% employer 67% investments
Unfunded Liability	$17.9 billion	$35.1 billion
Funded Status	59.2%	62.0%
Annual Benefits Paid[3]	$3.0 billion	$6.1 billion

[1] As of 12/31/2013. [2] As of 6/30/2014. [3] Calendar year 2014

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Useful Terms

➢ **Unfunded accrued liability** (UAL) – the difference between the actuarial value of assets and the actuarial value of pension liabilities (benefits).

➢ **Annual required contribution** (ARC) – the actuarially determined employer contribution. Includes: (1) the cost of benefits attributable to the current year of service (normal cost) and (2) amortization of the UAL.

➢ **Act 120 of 2010** – legislation that reduced benefits for employees hired after 1/1/2011 (SERS) and 7/1/2011 (PSERS).

➢ **Rate collars** – limitations on how quickly employer contribution rates rise to pay the unfunded liability. Results in funding that is lower than the ARC.

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Defined Benefit Plans

➤ A defined benefit (DB) plan provides retirement benefits based on members' years of service, salary history and a "multiplier" that can vary with the class of service.

➤ Pensions under a DB plan are formula-based and do not vary with the funding status of the plan.

➤ In contrast, defined contribution (DC) plans do not provide a predetermined benefit. The funds available in the DC plan ultimately determine the level of benefits.

Defined Benefit Plan Funding

- Employee contributions (percent of salary).
  - SERS: 6.25%
  - PSERS: 7.5%

- Investment earnings.
  - Assumed 7.5% long-term rate of return. Actual earnings are based on market conditions.
  - Significant losses during the 2008-2009 recession.

- Employer contributions.
  - Determined actuarially after accounting for fund liabilities, employee contributions and investment earnings. Effectively, one could think of it as a "residual."
  - Affected by "collars" that reduce contributions below actuarially determined levels.
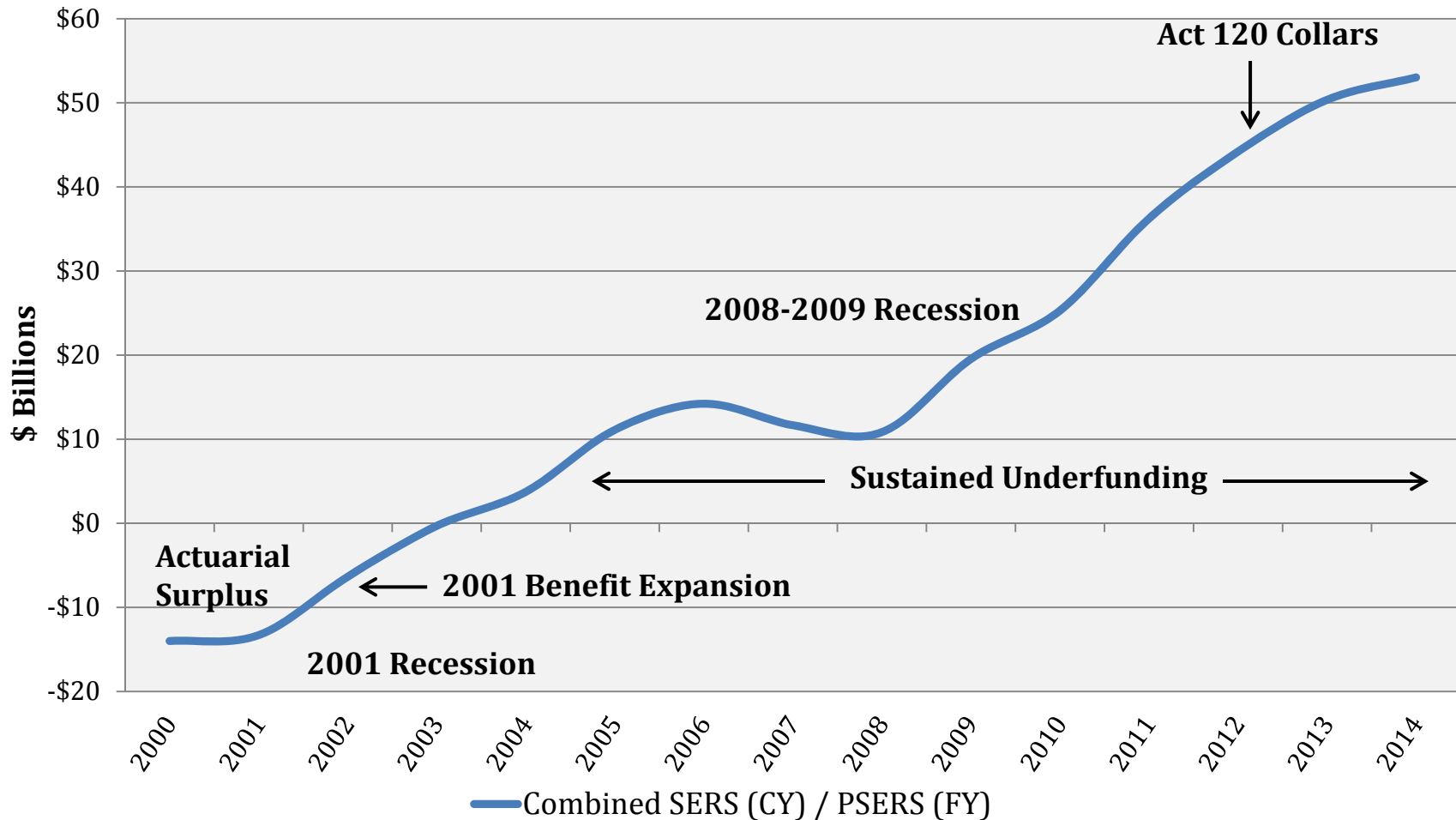
Unfunded Accrued Liabilities

Most Recent Actuarial Valuations

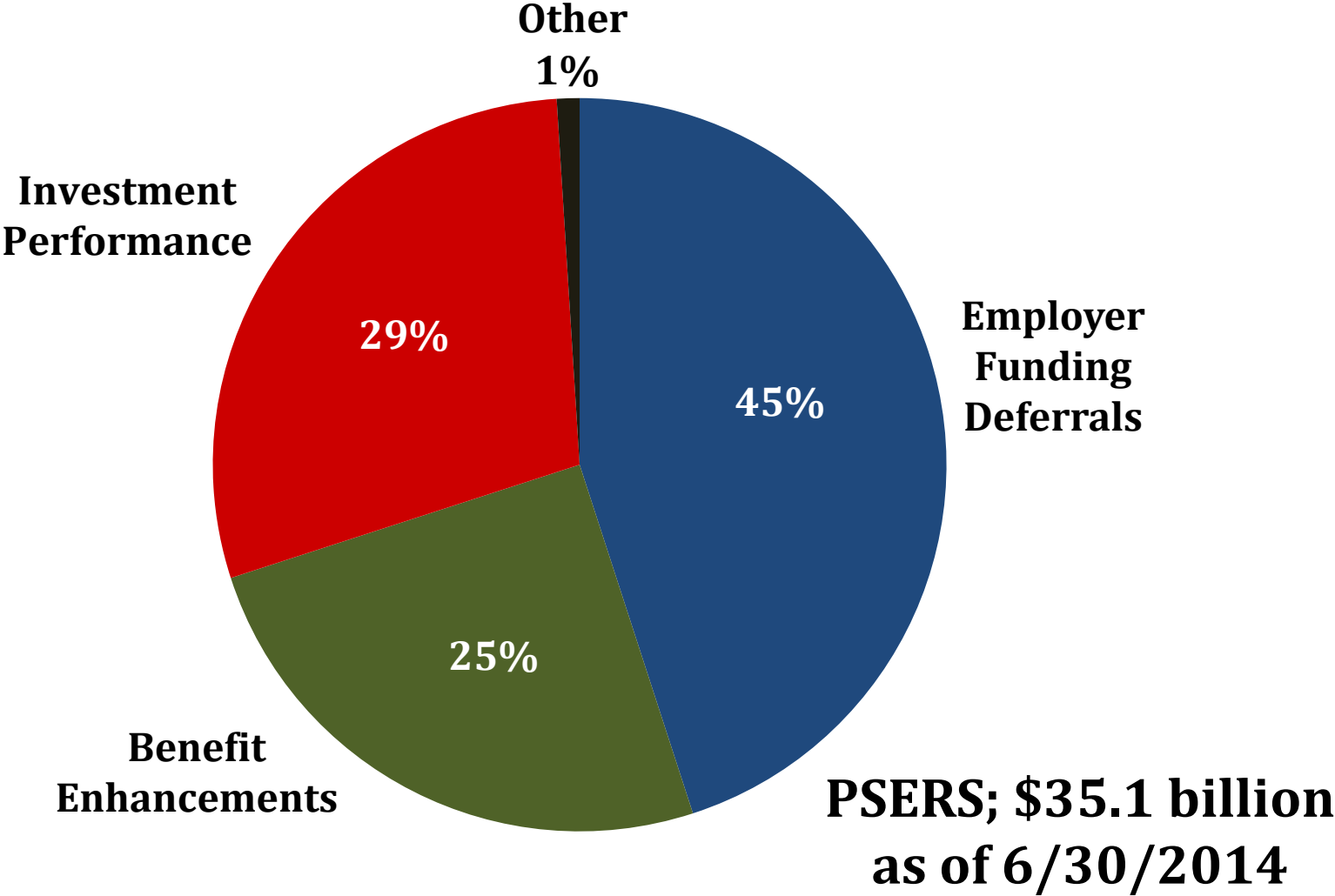|	SERS	PSERS	Total
Actuarial Value of Assets	$26.0	$57.3	$83.3
Actuarial Accrued Liability	<u>43.9</u>	<u>92.5</u>	<u>136.6</u>
Assets Minus Liabilities (Unfunded Liability)	-17.9	-35.1	-53.0

Note: Dollar amounts in billions. Sources: SERS 2013 Actuarial Report (June 2014) and PSERS June 30, 2014 Actuarial Valuation (January 2015)

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Unfunded Liability History

Sources: SERS Comprehensive Annual Financial Reports; PSERS Actuarial Valuations; multiple years.

Sources of Unfunded Liability

Other 1%

Investment Performance 29%

Employer Funding Deferrals 45%

Benefit Enhancements 25%

PSERS; $35.1 billion as of 6/30/2014

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Sensitivity of Earnings Assumption

➢ Estimates of the unfunded liabilities of the two pension systems are based on the 7.5% earnings assumption.

➢ Unfunded liabilities increase when the earnings assumption is reduced.

➢ A one percentage point reduction in the long-term rate of return (7.5% to 6.5%) increases liabilities:
  - SERS: ~$4.9 billion
 - PSERS: ~$9.8 billion
  - Total: ~$14.7 billion

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Unfunded Accrued Liabilities

Projected UAL by Fiscal Year

Fiscal Year	SERS	PSERS	Total
2015-16	$18.2	$39.4	$57.6
2016-17	**18.4**	41.4	59.8
2017-18	18.0	**42.9**	**60.9**
2018-19	17.4	42.3	59.7
2019-20	17.2	41.6	58.8
<u>Selected Out-Years</u>			
2024-25	15.6	37.2	52.8
2029-30	13.3	27.0	40.3

Note: Dollar amounts in billions. Sources: SERS 2015 Supplemental Budget Information (March 2015) and PSERS Current Employer Contribution Rate and 30 Year Projections (December 2014)
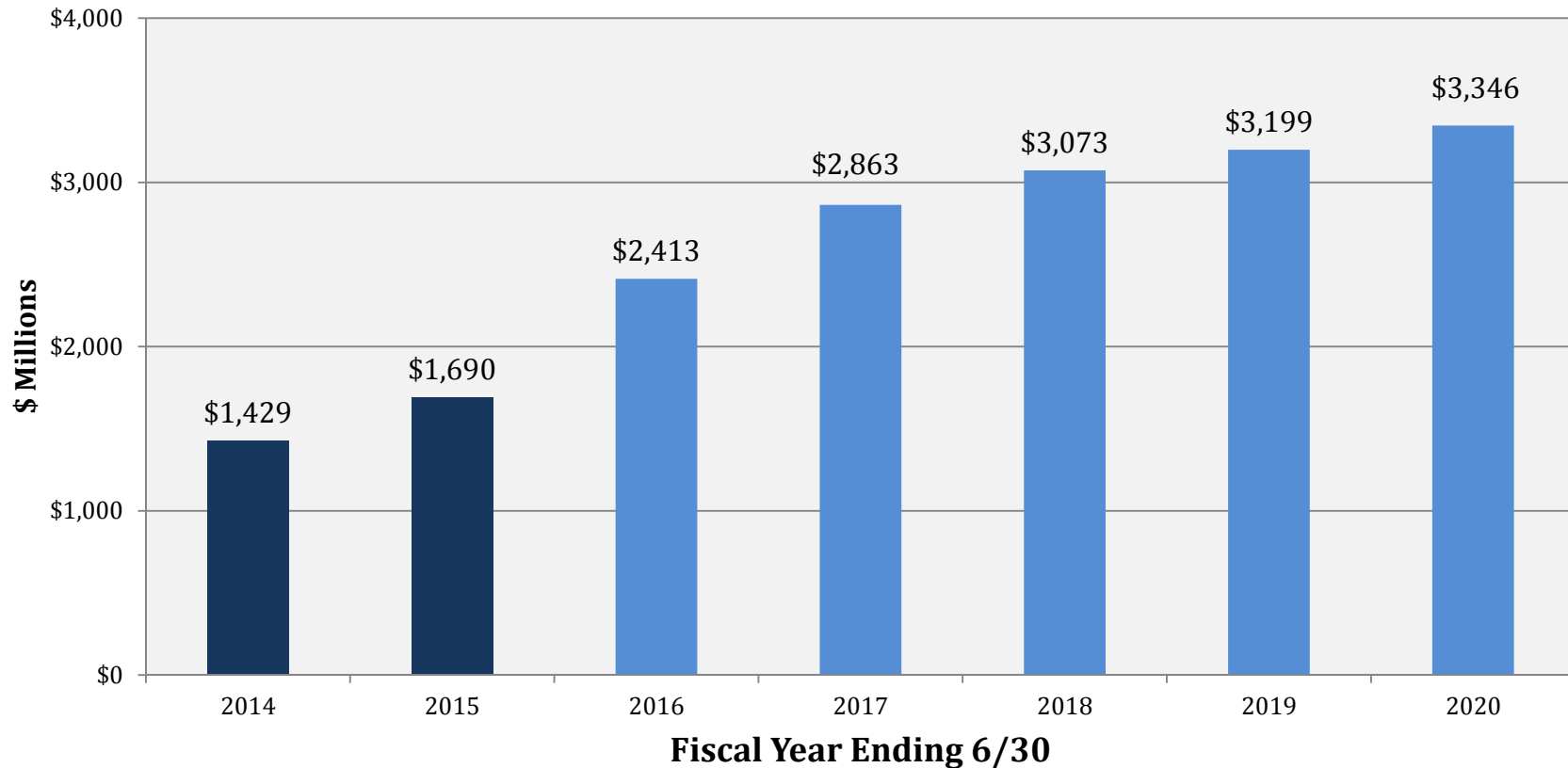
Employer Contribution Rates
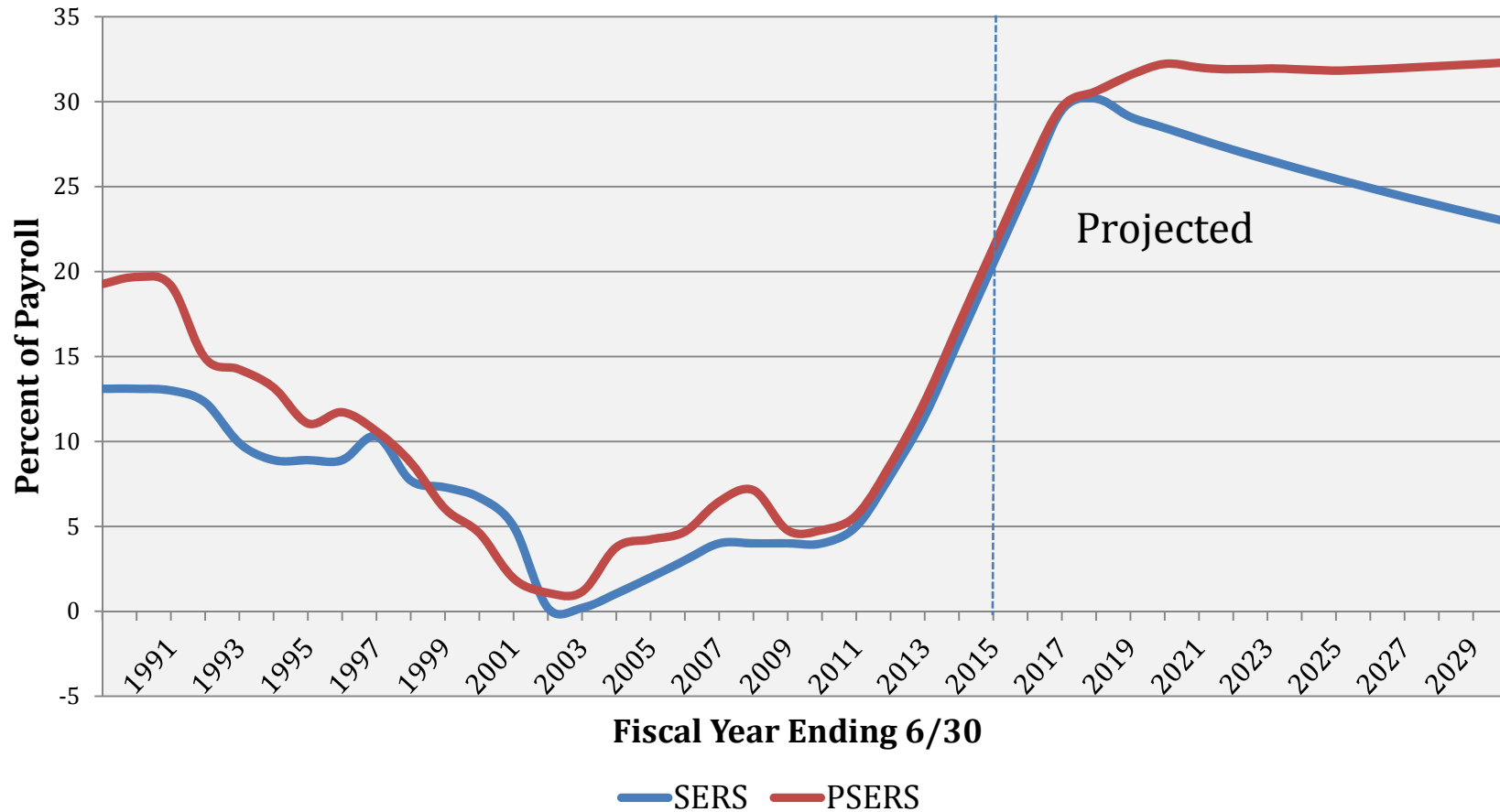
Sources for projections: SERS 2015 Supplemental Budget Information (March 2015) and PSERS Current Employer Contribution Rate and 30 Year Projections (December 2014)
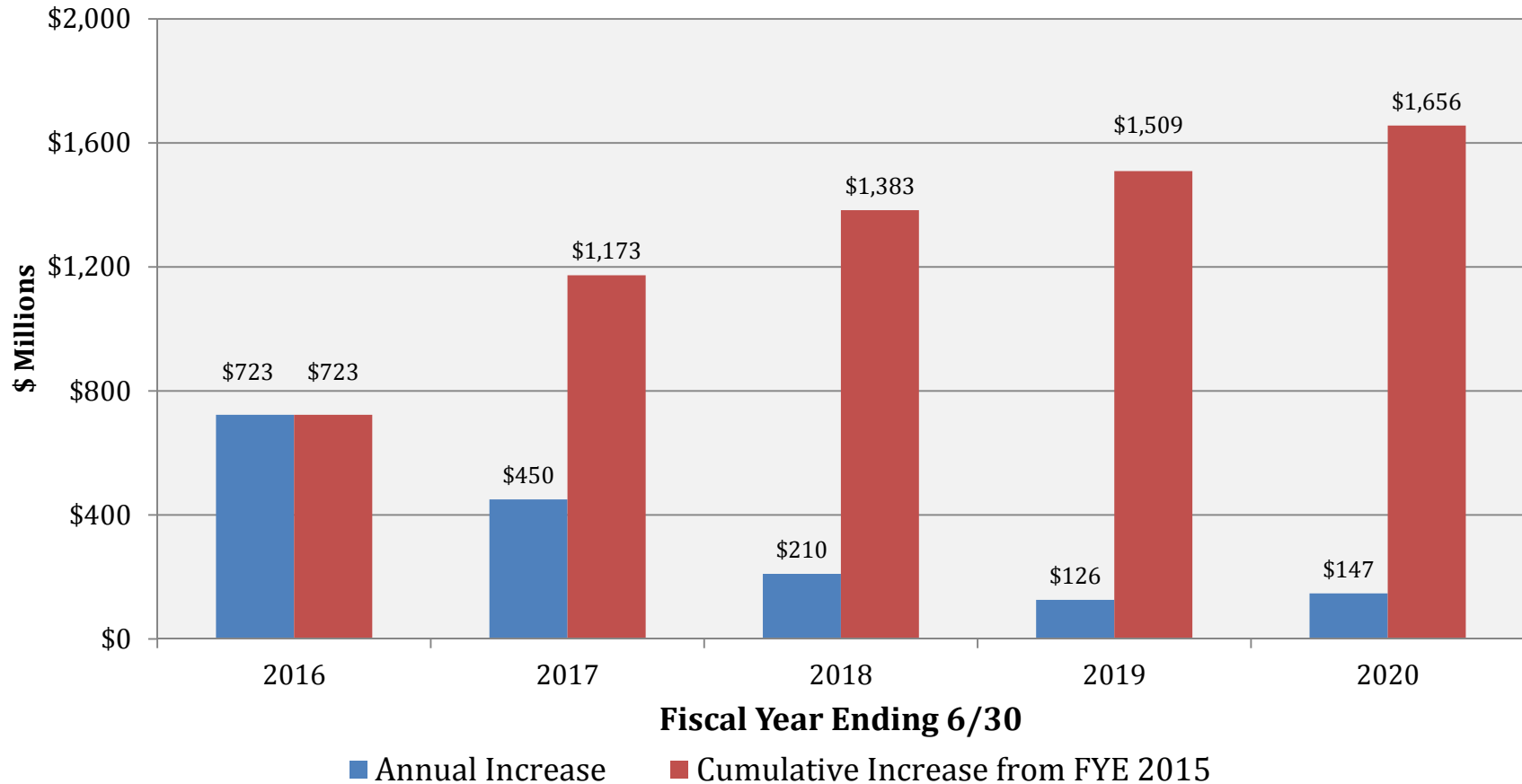
Pension Projections

General Fund Appropriations
SERS & PSERS Total

Source: Pennsylvania's Economic & Budget Outlook; Fiscal Years 2014-15 to 2019-20, Independent Fiscal Office, November 2014.

Pension Projections

General Fund - Annual and Cumulative Increases

Source: Pennsylvania's Economic & Budget Outlook; Fiscal Years 2014-15 to 2019-20, Independent Fiscal Office, November 2014.

Thank You

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