

Public School Employees' Retirement System (PSERS) Testimony
House Appropriations Committee
PSERS' 2019-2020 Budget Request
February 12, 2019

Melva Vogler, Chairman of the Public School Employees' Retirement System (PSERS) Board of Trustees, Glen Grell, PSERS' Executive Director, and James Grossman, Jr., PSERS' Chief Investment Officer will be available to answer questions during PSERS Budget Hearing.

First and foremost, I want to thank Governor Wolf, the General Assembly, school districts and other employers, for their commitment to continue to pay the full actuarially-required amount of employer contributions to PSERS. For the fourth year in a row, the Governor has proposed fully funding PSERS actuarially required amount of employer contributions. The Governor's proposed budget supports school districts in making the employer contributions necessary to pay down existing pension debt.

These contributions are making a positive difference for PSERS and the nearly half a million active and retired public school employees who depend on PSERS for their retirement benefit. These contributions have helped PSERS reach a major funding turning point this past year.

- **PSERS funded ratio improves one year earlier than projected.** Due to fully funded employer contributions, favorable demographic experience, and positive investment returns, the funded ratio, on an actuarial value basis, improved one year sooner than expected. The 56.5% actuarial funded ratio as of June 30, 2018, is a significant turning point for the System as future funded ratio projections are now expected to slowly and steadily rise, reversing years of decline since 2000. On a market value basis, PSERS' funded ratio, which began to improve in 2016, also continues to increase.
- **PSERS Unfunded Liability, on a market value basis, has declined by over \$3.5 billion over the last two fiscal years.**
- **PSERS' Negative External Cash Flow (NECF) percentage is more favorable than the public fund average for the first time in many years.** Full actuarially-required funding from the Commonwealth and school employers has improved and increased PSERS NECF to -2.5%, which is better than the public fund average of -2.8%. A lower NECF allows more investment earnings to be reinvested and improves the Fund's ability to grow assets in the future and continue to reduce the pension debt.

Second, PSERS administrative budget request this year for FY 2019-2020 is quite straightforward with a minimal increase due to an increase in personnel-related expenses required for the implementation of Act 5 of 2017. The Agency submitted an administrative budget request of \$51,644,000, a slight increase over last year's budget of \$51,637,000. For the benefit of new members to the Committee, PSERS is not a General Fund agency and all administrative costs are paid from the earnings of the Fund.

Thirdly, the employer contribution rate increase for FY 2019-2020 is the smallest since FY 2009-2010 and close to the rate of inflation. In addition, due to favorable demographic experience and investment performance, the FY 2019-2020 contribution rate is 1.24% lower than the rate projected two years ago. The lower rate results in a \$174 million reduction in contributions required from employers and the Commonwealth in FY 2019-2020.

I am also pleased to provide a few key highlights of PSERS achievements from the past year.

- **PSERS Pension Administration System Upgrade Successfully Completed** - The multi-year complete overhaul of PSERS pension administration system to a modern, browser-based application, that includes new Member Self-Service (MSS) and Employer Self-Service portals, was successfully completed in March 2018. This mission critical system is used by PSERS' staff members and employers to execute PSERS' primary pension administration functions for its members. This upgrade allows members and employers to conduct transactions for themselves which would have previously required staff intervention. Since March 2018, more than 110,000 members have created an MSS account and have conducted more than 78,000 transactions for themselves. The most common action taken was to update their nomination of beneficiaries.

This new system also enables members to select their preference for how they would like PSERS to communicate with them. To date, more than 98% of all MSS accounts have opted to go paperless and receive information from PSERS electronically. Since the launch of MSS in March 2018, PSERS saved more than \$180,000 in printing and mailing costs by using paperless delivery. We expect savings to continue to grow as more members join MSS.

- **PSERS Developed a Pension Forfeiture Tracking Application.** PSERS developed a new application to allow the System to query PA JNET (Justice Network) and AOPC (Administrative Offices of PA Courts) data feeds to more efficiently identify PSERS members who have been charged, convicted of, or pled guilty or no defense to one of the offenses defined in the Pension Forfeiture Act. Although PSERS has an excellent record of identifying forfeiture cases in a timely manner, the connection with JNET and AOPC will further enhance our ability to trigger forfeitures.
- **Act 5 Implementation Is Progressing.** On June 12, 2017, Governor Wolf signed Act 5 of 2017 into law. This pension legislation represents a substantial change to PSERS' operations and made significant changes to PSERS' benefit structure for future members. Under Act 5 of 2017, school employees who become new members of PSERS on July 1, 2019 and thereafter will choose one of three new retirement plan options for their retirement benefits. The new plan design options include two hybrid plans consisting of defined benefit (DB) and defined contribution (DC) components and a stand-alone defined contribution plan. The current stand-alone defined benefit plan will no longer be available to new members.

PSERS is undertaking a major effort to implement the new plan designs by the implementation date of July 1, 2019. Voya Institutional Plan Services (VIPS) was selected as the Third Party Administrator for the DC plan. Additionally, after extensive due diligence and analysis by PSERS Investment professionals and pension consultant Charles W. Cammack Associates, PSERS Board selected T. Rowe Price Retirement Blend Target Date Funds as the default investment option for DC plan participants.

PSERS also completed and submitted the draft Plan Document for the new DC plan for approval to the Internal Revenue Service (IRS) on behalf of the PSERS Board of Trustees. Recently PSERS received very minor review comments from the IRS and we expect approval in 30-90 days.

PSERS professionals are dedicated to maintaining the high quality and excellence standards of PSERS current defined benefit plan while implementing new DC features. Act 5 requires major changes to the System's pension administration software to be able to handle both DB changes and the interaction with Voya for the DC component of Act 5. Additionally Act 5 requires significant reporting and software updates for PSERS 750+ school employers. PSERS professionals are working closely with Voya to train and educate school employers on Act 5.

- **PSERS Board Members and Designees Exceed Act 5 Education Requirements.** Act 5 required PSERS Board of Trustees to receive 8 hours of investment-related education each year. We are pleased to report that PSERS 15 statutory Board members and their designees completed over 600 hours of investment-related education and ethics training. On average, each board member and designee received over 21 hours of education, far exceeding the education requirement created in Act 5.
- **PSERS Investment Professionals Developed an Investment Fee Savings Plan that Saves Over \$2.4 billion.** Act 5 established a goal for PSERS to develop a plan to save \$1.5 billion in management fees over 30 years. PSERS Board also directed PSERS Investment Professionals and the Board's investment consultants to create a fee savings plan. The plan was presented and approved at the August 2018 Board Meeting.

PSERS Investment Professionals took a two-pronged approach to generate fee savings.

- The first was to establish a plan to renegotiate management fee arrangements to create a better alignment of interest between PSERS and each investment manager. The goal was to decrease the guaranteed fees, or base fees, in exchange for a profit-sharing arrangement on returns above a negotiated benchmark. Estimated savings from these reduced guaranteed fees amounted to over \$1.5 billion compounded over 30 years.
- The second was to expand internal management and bring additional assets in-house at a lower cost than external management. Net of the cost of the additional 9

investment professionals needed, we estimated savings of over \$900 million compounded over 30 years.

Together, the cumulative fee savings are \$2.4 billion compounded over 30 years, which represent a 9.6% annual reduction in base management fees.

PSERS fee savings plan crafted is by no means an end to our efforts to reduce management fees and better align the interests of the investment managers with PSERS. Since the plan was prepared, we've identified over \$350 million in additional cumulative base fee savings compounded over 30 years. The cumulative fee savings have now increased to \$2.8 billion compounded over 30 years, a 10.4% annual reduction in base management fees.

- **PSERS Continued to Explore and Implement Ways to Increase Fee Savings and Improve Efficiencies in Its Investment Operations.** PSERS aggressively negotiates all management fee terms with new managers and mandates.

The investment professionals at PSERS are always looking to negotiate the fairest fee deal possible. To that end, PSERS recently implemented a formal External Manager Fee Policy to document fee negotiations. In addition, we've instituted a formal internal policy of reviewing all fee arrangements at least once every two and a half years to ensure that each fee arrangement is still favorable to the System. All fee negotiations are now formally documented and saved in our document management system in accordance with recommendations from the Auditor General in a past performance audit.

- **PSERS Provided Testimony to the Public Pension Management Asset Investment Review Commission Created Under Act 5 of 2017.** PSERS provided expert testimony to the Commission in October 2018 and provided an enormous amount of investment data through Commission requests. The Commission issued a report with 100+ recommendations in late December 2018. PSERS Board and Investment Professionals are currently reviewing the 400 page report in detail to identify more opportunities to improve PSERS investment operations and efficiencies.

In closing, please refer to the *PSERS on Point (POP)* for more information on PSERS accomplishments over the past year.

We are prepared to answer any questions you may have concerning the budget materials we provided to you, or about the Agency in general. Thank you.