

Minutes of the Finance & Member Services Committee Meeting
July 29, 2020
Via Conference Call

Attendees:

Committee Members and Designees

Ms. Mary A. Soderberg (Chair)
Senator John M. DiSanto
Mr. David R. Fillman
Mr. Gregory C. Thall
Representative Michael G. Tobash (in person)

Other Board Members and Designees

Mr. Glenn E. Becker
Mr. Charles Erdman (Designee for Senator John M. DiSanto)
Mr. Dan Ocko (Designee for Representative Dan B. Frankel)
Mr. Patrick Shaughnessy (Designee for Representative Dan B. Frankel)
Ms. Toni Marchowsky (Designee for Senator Vincent J. Hughes)
Mr. Gregory K. Jordan
Ms. Susan Boyle (Designee for Representative Michael G. Tobash)
Treasurer Joseph M. Torsella
Mr. Lloyd Ebright (Designee for Treasurer Joseph M. Torsella)
Mr. James Bloom (Designee for Acting Secretary Richard Vague)
Mr. Alan Flannigan (Designee for Acting Secretary Richard Vague)

Executive Staff

N. Joseph Marcucci
Sara McSurdy
James Nolan
Terrill Sanchez, Board Secretary

Consultants

Brent Mowery, Korn Ferry Hay Group
Kris Seets, Korn Ferry Hay Group
Jay Kloepfer, Callan Associates, Inc.
Britt Murdoch, Callan Associates, Inc.
Bud Pellecchia, Callan Associates, Inc.

1. Call to Order

Chair Soderberg called the meeting to order at 8:34 A.M.

2. Welcome and Introductions

None

3. Approval of Minutes

By motion that was moved by Mr. Fillman, seconded by Mr. Thall, and approved unanimously by Committee members, it was RESOLVED: That this Committee approves the minutes of the June 9, 2020 Finance and Member Services Committee meeting.

4. Old Business

None

5. Special Presentations**a. 5-Year Experience Study/Assumed Rate of Return – Korn Ferry and Callan (via Skype)**

Representatives from Korn Ferry and Callan Associates, Inc. presented a high-level and comprehensive overview of this agenda topic for the Committee's review, consideration, and discussion.

SERS' actuaries, Korn Ferry, completed its 19th investigation of actuarial experience covering the five-year period of January 1, 2015 through December 31, 2019 that included an analysis of the assumed rate of return, which is currently at 7.125%.

The presentation included key findings and assumption recommendation changes resulting from the actuarial experience study. They presented information on the impacts of keeping the current 7.125% assumed rate of return versus changing it to a 7.00% assumed rate of return, and of lowering the rate of inflation from 2.6% to 2.5%. Other recommendation changes were to various economic and demographic assumptions. The presentation also included information on the approximate cost impact if the recommended assumption changes were adopted.

After some discussion among the Committee Members and other Board Members, the Committee unanimously agreed to lower the discount rate and inflation rate. The Committee also unanimously moved to adopt the recommended assumptions changes in the 5-year experience study report. As a result, the Committee made the following motions:

- By Motion that was moved by Mr. Tobash, seconded by Mr. Thall, and approved unanimously by Committee Members, it was RESOLVED: That this Committee recommend that the State Employees' Retirement Board:

- (i) lower the current annual assumed rate of investment return; and
- (ii) lower the current assumed rate of inflation; and, thus
- (iii) adopt an annual assumed rate of investment return of 7.00%, compounded annually, and an annual assumed rate of inflation of 2.50%, compounded annually, with both assumptions to be effective with the December 31, 2020 Actuarial Valuation, and to remain in effect until further action by the Board.

The roll call vote tabulation was as follows:

Yes: Ms. Soderberg (Committee Chair), Mr. Fillman, Senator DiSanto,
Mr. Thall, Representative Tobash

- By Motion that was moved by Senator DiSanto, seconded by Mr. Fillman, and approved unanimously by Committee Members, it was RESOLVED: That this Committee recommend that the State Employees' Retirement Board:

Adopt the actuarial assumptions and recommended changes to the current actuarial assumptions set forth in the report by Korn Ferry titled "Summary of Recommended Changes to Actuarial Valuation Assumptions Based Upon the 19th Investigation of Actuarial Experience Covering the Period January 1, 2015 to December 31, 2019 To Be Effective With the December 31, 2020 Actuarial Valuation," which report is attached hereto as "Attachment A."

The roll call vote tabulation was as follows:

Yes: Ms. Soderberg (Committee Chair), Mr. Fillman, Senator DiSanto,
Mr. Thall, Representative Tobash

6. New Business/Discussion Items Only

- a. **Finance Update** – At this time, Sara McSurdy introduced herself as SERS' Chief Financial Officer and provided some highlights within the Office of Finance, which included the following:
- Published Comprehensive Annual Financial Report (CAFR) by June 30th deadline;
 - Provided employers with the GASB 68 reporting, which was audited by KPMG with no issues reported;
 - Submitted FY 20/21 re-budget to GBO, with FY 21/22 budget process kick-off;
 - Staffing updates within the Office of Finance; and
 - The Defined Benefit Plan Statement of Changes; Defined Contribution Plan Statement of Changes; and Deferred Compensation Plan Statement of Changes were provided, noting that the monthly statements of changes for all three Plans will now appear on the Board's Consent Calendar for consistency.
- Chair Soderberg congratulated Ms. McSurdy on her recent promotion to Chief Financial Officer.
- b. **FY 2020/21 State Employees' Defined Contribution (DC) Plan Per Participant Administrative Charge to Employers** – Ms. McSurdy provided details on this agenda topic where the DC plan was appropriated approximately \$4.6 million, but instead of funding coming from personal income tax revenues per previous fiscal codes, the fiscal codesigned into law as Act 2020-23 on May 29, 2020, gave the Board the authority to charge a per-participant fee to each employer for its proportionate share of the administrative fees, costs, and expenses associated with the DC plan. The Committee was provided with an overview of how the per-participant charge was developed, and how that will affect the generating of employer invoices. As a result of the short time frame, she discussed the phased-in invoicing approach that is anticipated to be taken, with the Governor's agencies being invoiced and submitting payment first. The Committee unanimously agreed to move forward with the per-participant charge and invoicing strategy, and made the following motion:

By Motion that was moved by Mr. Thall, seconded by Mr. Fillman, and approved unanimously by Committee Members, it was RESOLVED: That this Committee recommend that the State Employees' Retirement Board:

- (1) Assess each employer that has one or more employees who were active participants in the State Employees' Defined Contribution Plan as identified in the census certified to the Board's actuary as of December 31, 2019, a per-participant charge of \$668.77 for each such employee to cover the administrative fees, costs, and expenses associated with the State Employees' Defined Contribution Plan for fiscal year 2020-2021, as authorized in the Act of May 29, 2020, P.L. 158, No. 23, Section 8 (Fiscal Code Section 1748-E (a));
- (2) For each fiscal year starting on or after July 1, 2021, delegate to the Secretary of the Board and administrative staff of the State Employees' Defined Contribution Plan the authority to:
 - (a) determine the employer per-participant charge by dividing the budgeted needs of the State Employees' Defined Contribution Plan for administrative fees, costs, and expenses for the fiscal year not covered by other sources of funds by the total number of active participants in the State Employees' Defined Contribution Plan contained in the census certified to the Board's actuary as of the prior December 31; and
 - (b) assess each employer that employed active participants as of the applicable December 31, as certified by the Board to the actuary, the resulting employer per-participant charge for each such active participant; and
- (3) For fiscal year 2020-2021 and each fiscal year thereafter, delegate to the Secretary of the Board and administrative staff of the State Employees' Defined Contribution Plan the authority to:
 - (a) invoice each employer assessed employer per-participant charges;
 - (b) require payment, in the form, manner, time, and amount as the Secretary and administrative staff determine, provided that no date by which payments must be received by an employer can be greater than 90 days from the date of the invoice to that employer; and
 - (c) develop, assess, and collect a schedule of interest, fees, and penalties for the late payment of employer per-participant charges.

The roll call vote tabulation was as follows:

Yes: Ms. Soderberg (Committee Chair), Senator DiSanto, Mr. Fillman, Mr. Thall, Representative Tobash

Ms. McSurdy concluded by briefly discussing the topic of forfeiture accounts, indicating that while no action is required by the Committee, this is an important issue that SERS staff has been meeting (and will continue to meet) with General Assembly leadership to discuss. Currently, when an employee or participant in the DC plan terminates before having three eligibility points, they receive their own contributions and earnings; but the employer's contributions and earnings are returned to their last employer. This money goes into an employer level forfeiture account that the employer can use towards future contributions to the DC plan. Ms. McSurdy stated that the DC plan would like to change this process and redirect these funds to go into a plan level forfeiture account to be used to pay administrative costs of the DC plan. This would (i) put SERS in line with how PSERS accounts for these monies; (ii) create an administrative efficiency, and (iii) reduce the per-participant charge previously discussed. Legislation would be required to move forward with Ms. McSurdy's suggestion.

7. New Business/Informational Items Only

The Committee was also provided with the following informational items to review at their convenience:

- a. Directed Commissions (January, February, March, and April)
- b. Total Commissions (January, February, March, and April)
- c. Membership and Benefits lists (March and April)

8. Executive Session

None

9. Board Comments/Concerns/Questions

None

10. Motion to Adjourn

By motion that was moved, seconded, and approved unanimously by Committee Members, it was:
RESOLVED: That this meeting be adjourned at 10:04 A.M.

Respectfully submitted,



Sara McSurdy
Chief Financial Officer



Joseph A. Torta, Director
Office of Member Services



**Summary of Recommended Changes to Actuarial Valuation Assumptions
Based Upon 19th Investigation of Actuarial Experience,
Covering the Period January 1, 2015 to December 31, 2019,
To Be Effective with the December 31, 2020 Actuarial Valuation**

I. Economic Assumptions

- a. Annual Inflation Assumption & General Salary Increase Assumption: Based upon the gradual downward trend in U.S. inflation and the recent action by the Social Security Administration to lower their projection of future annual inflation, Korn Ferry recommends a decrease in the annual inflation assumption from 2.60% to 2.50%. Because this annual inflation assumption is also a component of the general salary increase assumption (which estimates annual across-the-board pay increases to active SERS members), Korn Ferry therefore also recommends a decrease in the general salary increase assumption from 2.90% to 2.80% per year
- b. Career Salary Increase Assumptions (which estimate average annual salary increases due to merit and promotions): Since actual career salary increases observed over the study period were lower than expected, with significantly lower rates of salary growth in the first few years of employees' careers, Korn Ferry recommends reductions at every service level, ranging from 0.30 percent to 1.85 percent decreases, and averaging about 0.7 percent lower. The table below shows the specific assumptions being recommended:

| Years of Credited Service | Current Assumed Annual Increase in Career Salary | Recommended Assumption - Annual Increase in Career Salary | Years of Credited Service | Current Assumed Annual Increase in Career Salary | Recommended Assumption - Annual Increase in Career Salary |
|---------------------------|--|---|---------------------------|--|---|
| 1 | 6.00% | 4.15% | 16 | 2.10% | 1.25% |
| 2 | 4.50% | 3.25% | 17 | 2.05% | 1.20% |
| 3 | 4.00% | 2.90% | 18 | 2.00% | 1.15% |
| 4 | 3.75% | 2.70% | 19 | 1.95% | 1.15% |
| 5 | 3.50% | 2.50% | 20 | 1.90% | 1.10% |
| 6 | 3.25% | 2.35% | 21 | 1.85% | 1.00% |
| 7 | 3.00% | 2.15% | 22 | 1.75% | 0.95% |
| 8 | 2.90% | 2.10% | 23 | 1.65% | 0.90% |
| 9 | 2.80% | 2.00% | 24 | 1.55% | 0.85% |
| 10 | 2.70% | 1.60% | 25 | 1.45% | 0.80% |
| 11 | 2.60% | 1.55% | 26 | 1.25% | 0.70% |
| 12 | 2.50% | 1.45% | 27 | 1.05% | 0.60% |
| 13 | 2.40% | 1.40% | 28 | 0.90% | 0.50% |
| 14 | 2.30% | 1.35% | 29 | 0.85% | 0.50% |
| 15 | 2.20% | 1.30% | 30+ | 0.80% | 0.50% |



II. Demographic Assumptions

- a. Annuitant Mortality Assumptions: Although the actual 2015-2019 mortality experience of SERS annuitants did not deviate significantly from our current assumed death rates, in order to better reflect the mortality experience of SERS annuitants, we recommend a revised set of mortality assumptions based upon the Society of Actuaries' Pub-2010 study of public sector retirement systems and their most recent forecast of future mortality improvements (future increases in life expectancy). Therefore, we recommend the following updated mortality assumptions:

Male Non-Disabled: PubG-2010 Male Mortality Table, with post-2010 mortality improvement based on Scale MP-2019 for Males

Female Non-Disabled: PubG-2010 Female Mortality Table (set forward 1 year), with post-2010 mortality improvement based on Scale MP-2019 for Females

Male Disabled: PubNS-2010 Male Mortality Table (set forward 2 years), with post-2010 mortality improvement based on Scale MP-2019 for Males

Female Disabled: PubNS-2010 Female Mortality Table (set forward 2 years), with post-2010 mortality improvement based on Scale MP-2019 for Females

- b. Superannuation Retirement Assumptions Applicable to General Employees (i.e., Classes AA and A): In general, for both males and females, (i) relatively fewer employees are retiring at, or prior to, the earliest superannuation ages and (ii) relatively more are deferring retirement until Social Security Retirement Ages (65-66) or beyond. Therefore, we recommend:

For Males: Lower retirement rates prior to age 64,

For Females: Lower retirement rates from ages 60 through 64 and

For Both Males and Females: Higher retirement rates after age 64

- c. Other Demographic Assumptions:

i. Applicable to all active employees, we recommend –

1. Decreases to mortality rates; for both males and females
2. Decreases to disability retirement rates for both males and females
3. Increases to employee withdrawal rates for both males and females

ii. Applicable to general (Classes AA & A) employees, we recommend –

1. Decreases to early retirement rates for those with 15+ years of service for both males and females
2. Slight decreases to early retirement rates for those with < 15 years of service for both males and females

iii. Applicable to employees in various special benefit classes, we recommend –

1. Changes to superannuation rates as follows: Increases for state police (> 19 years service), other hazardous duty employees and legislators; decreases for judges/justices



2. Changes to early retirement rates as follows: Increases for state police, other hazardous duty employees and legislators; decreases for judges/justices
3. Changes to withdrawal rates as follows: Increases for state police, other hazardous duty employees and judges/justices; decreases for legislators

III. Special Assumptions

- a. Form of Payment: This experience study included a review of the forms of payment elected by retiring SERS participants over the 2015-2019 period. Based upon this experience, we recommend minor adjustment to the current Form of Payment assumptions, as follows:

| Form of Payment | Current Assumptions | 2015-2019 Experience | Recommended Assumptions |
|--|---------------------|----------------------|-------------------------|
| I. Single Life Annuity | 32% | 33.3% | 33% |
| II. Option 1 (Guaranteed PV) OR Option 1 combined with joint and survivor Option | 43% | 41.0% | 41% |
| III. Option 2 (100%) or 3 (50%) or other % to survivor | 25% | 25.7% | 26% |
| IV. Total | 100% | 100.0 | 100% |

- b. Probability of Electing Full Option 4 Withdrawal: This experience study included a review of the contributions and interest actually withdrawn by retirees out of the total contributions and interest available for withdrawal over the 2015-2019 period. Based upon our findings, we recommend that the percentage of retirees assumed to elect a full Option 4 withdrawal of contributions and interest be revised as follows:

| From Current Assumption of: | To Recommended Assumption of: |
|-----------------------------|-------------------------------|
| 80% | 70% |

- c. Years of Purchased Service by Eligible Members:

| Service | Number of Years Purchased |
|---------|---------------------------|
| 0 | 0.08 |
| 1 | 0.06 |
| 2 | 0.04 |
| 3 | 0.02 |
| 4+ | 0.00 |

This experience study included a review of purchases of service by eligible SERS members over the 2015-2019 period. Our study revealed a significant overall decline in purchases of



service since this was last studied. We also determined that this lower level of activity of purchasing service is expected to continue. Therefore, Korn Ferry recommends the adoption of the purchased service assumptions included in the table above, which represent significantly lower levels of service expected to be purchased by eligible members of SERS in the future. Note that the assumed years purchased as shown above are reduced by 9% for Class A-3 and A-4 members.

IV. Actuarial Certification

This summary presents actuarial valuation assumption change recommendations being made by Korn Ferry based upon our investigation of the actuarial experience of the State Employees' Retirement System (SERS) of the Commonwealth of Pennsylvania, covering the period from January 1, 2015 to December 31, 2019. Excluded from the assumptions addressed in this summary is the annual investment return assumption, the selection of which will be made by the SERS Board at their meeting of July 29, 2020.

Otherwise, to the best of our knowledge, this summary is complete and accurate, and all recommended assumptions included herein are reasonable actuarial assumptions which represent our best estimate of anticipated experience under the plan, determined in accordance with the applicable actuarial standards of practice.

The actuaries certifying to these results and recommendations are members of the Society of Actuaries or other professional actuarial organizations and meet the Qualification Standards of the American Academy of Actuaries for purposes of issuing Statements of Actuarial Opinion.

Respectfully submitted,
Korn Ferry
July 17, 2020

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