2019 SERS Budget Highlights

pennsylvania
STATE EMPLOYEES' RETIREMENT SYSTEM

The Pennsylvania State Employees' Retirement System currently serves approximately 240,000 active, inactive, vested and retired members. Last year, the system paid nearly $3.4 billion in benefits of which approximately $3.1 billion (approximately 91%) was issued to SERS members who live in Pennsylvania. For 2018, the average pension paid to retirees who work to full retirement age was about $28,880.

For FY 2018-19, we are seeking spending authority for $30.5 million from SERS funds, not general government operating accounts, a decrease of 0.72% from the current fiscal year and $3.8 million, which will be appropriated from non-SERS funds for the new Defined Contribution Plan.

Economic Volatility

In 2018, SERS experienced an estimated investment loss of 4.3% due mainly to high market volatility, especially during the fourth quarter. The impact was felt around the world. During 2018, the Dow Jones Average fell 5.6%. The S&P 500 was down 6.2% and the Nasdaq fell 3.9%. Globally, the FTSE All-World index, which tracks thousands of stocks across a range of markets, fell 11.3% in 2018. In short, it was a challenging year.

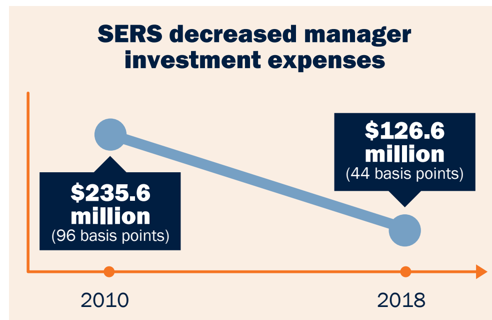
Even in the face of such economic challenges, SERS continues striving to improve services to our stakeholders, as well as improve efficiencies in the delivery of benefits and reduce costs in the administration of the system for our employers. Reducing investment fees has been an ongoing goal for SERS. Since 2010, we have reduced fees and expenses for our investment program by more than $109 million.

SERS paid nearly **$3.4 billion** in benefits in 2018

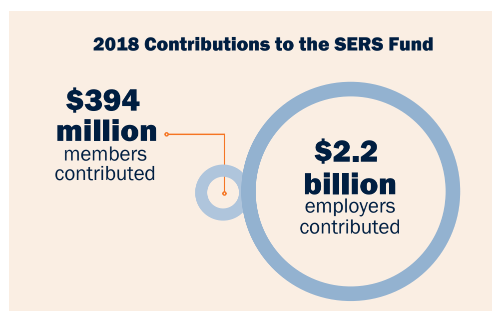
In 2018 SERS retired **4,680** members and welcomed **11,257** new members

SERS average active member
46 years old | **12** years of service

SERS average retired member
72 years old | receives **$28,880** per year



41% of SERS active employees belong to post-Act 120 classes of service



Total FY 19/20 Spending Request

$34.4 million

$1.5 million directed commissions

Actuarially Required Contributions

One of the key reasons SERS has been able to continue paying promised benefits to its members – even in spite of profound economic challenges – is the fact that, for the past three years, the commonwealth has paid the actuarially required contribution to the fund. This was not always the case.

In the not-too-distant past, we saw first-hand, how persistent underfunding can jeopardize a plan's sustainability, eating away at the asset base, forcing decisions to liquidate investments at inopportune times, and pushing a retirement board to reach for returns that otherwise may not be needed, and which are often attained only through expensive investment alternatives.

Funding the actuarially required contribution allows us to continue moving toward an asset allocation strategy where we not only look to get the best return for the risk we take, but where we also take less risk overall, and pay promised benefits cost-effectively.

Act 2017-5

During 2018, SERS provided information and testimony to the Public Pension Management and Asset Investment Review Commission, created as a result of Act 2017-5 to study, identify and recommend ways the Commonwealth's public pension funds might improve their processes in regard to transparency, investment strategies and performance, stress testing and more. The SERS board is currently reviewing more than 100 specific recommendations from the commission's final report. We look forward to working with the general assembly to review and act upon their recommendations.

Act 2017-5 also brought important changes to the retirement options for most new hires beginning January 1, 2019. For most new members, this legislation establishes two hybrid defined benefit/defined contribution options and a straight defined contribution plan. In addition to new hires, current members will have the opportunity to opt-in between January 1, 2019, and March 31, 2019. During the second half of 2018, SERS staff worked hard to develop communications programs to educate members about their choices, and we are working with them now to provide guidance and support as they make their selections.

Total FY 19/20 Spending Request

$34.4 million

$30.5 Million SERS Fund
$3.8 Million Non-SERS Fund For Defined Contribution

$1.5 million directed commissions

$20.0 million	$15.6 million	$0.3 million
personnel	operations	fixed assets
+2.5% from FY 18/19	-4.38% from FY 18/19	No change from FY 18/19

IT consulting-system upgrade	**$4.3 million**
real estate	**$2.1 million**
treasury services	**$1.5 million**
postage	**$0.7 million**
legal services	**$0.6 million**
office equipment	**$0.2 million**

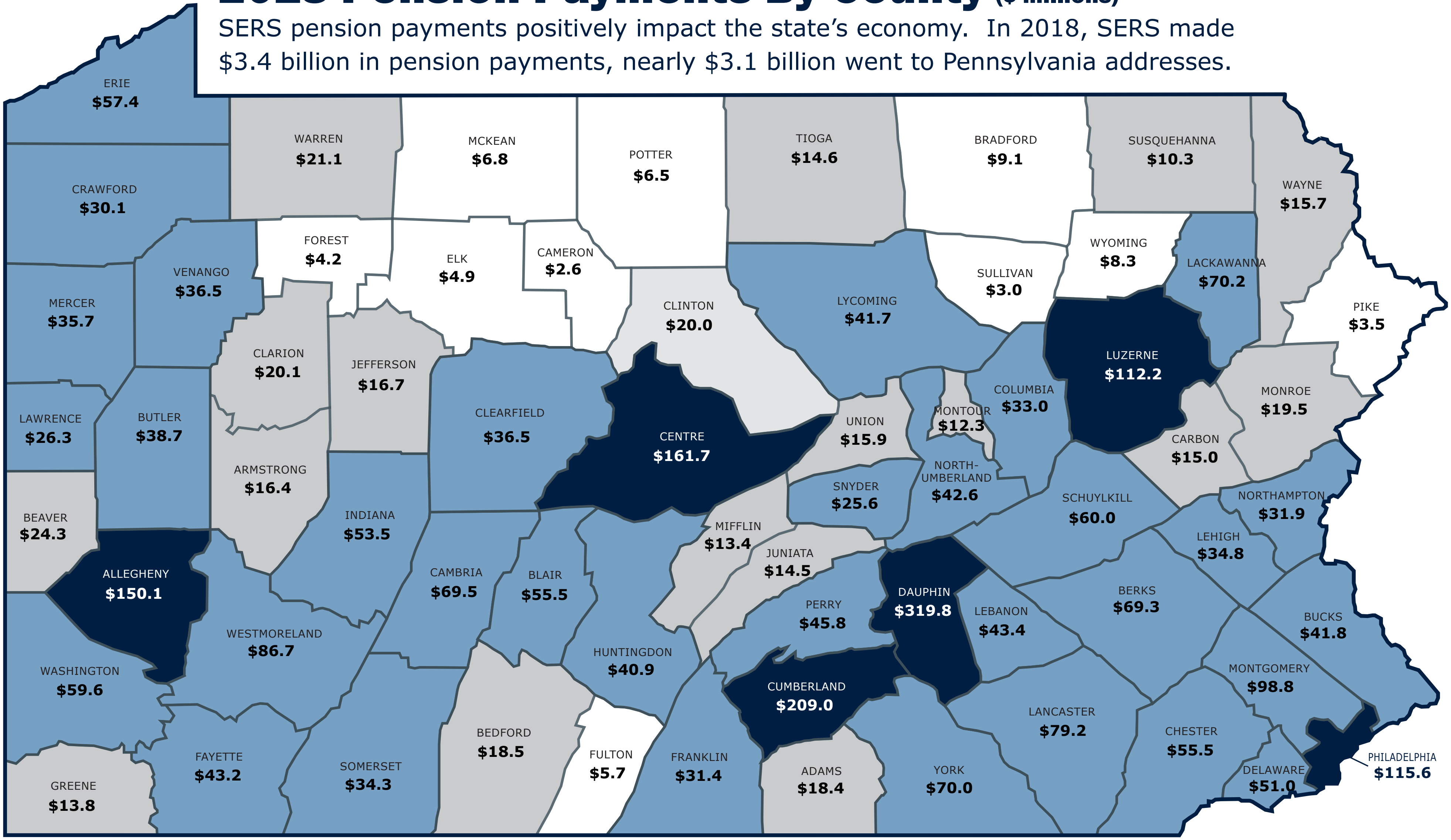
pennsylvania
STATE EMPLOYEES' RETIREMENT SYSTEM

Snapshot

Members as of Dec 31, 2018	240,972 131,007 retirees and beneficiaries receiving benefits 103,147 active members paying into the system 6,818 vested members not receiving benefits	**Ratio** Active : Retired 1 : 1.27
Average 2018 Annuity Paid	$22,720 per year $28,880 per year for those who work to full retirement age	
Total Benefits Paid as of Dec 31, 2018, unaudited	$3.4 billion	
Member Contribution Rate PA FY 2018/19	6.25% of salary, by payroll deduction (for most members) Varies between 5% and 9.3%	
Number of Employers as of Dec 31, 2018	102	
Employer Contribution Rate PA FY 2018/19	4.88% of payroll for benefits earned this year 28.05% of payroll for the unfunded liability **32.93%** of payroll, composite rate	
Projected Employer Contribution Rate PA FY 2019/20	4.90% of payroll for benefits earned this year 28.50% of payroll for the unfunded liability **33.37%** of payroll	
Employer Contribution Sources % provided by the Governor's Budget Office (FY 2017/18)	approx. 40% general funds approx. 52% other state funds approx. 8% independent employer funds	
Funding Sources as of year-end Dec 31, 2018, unaudited	$394 million member contributions $2.2 billion employer contributions ($1.7) billion investment earnings	
Investment Returns as of Dec 31, 2018 unaudited, annualized, net-of-fees	-4.3% 1-year 7.2% 10-year	6.0% 20-year 8.4% 30-year
Total Fund Assets as of Dec 31, 2018, unaudited	$26.8 billion	
Cash Flow 2019 projected	$2.46 billion annual contributions (member/employer) $3.61 billion annual payments (benefits/administrative expenses) difference in sum necessary to cover payments must come from investment income	
Funded Status 2017 actuarial report adjusted with preliminary 2018 year-end performance data	56.5% with an unfunded liability of $22.3 billion	
Key Assumptions 2017 Actuarial Report	7.25% investment return 5.60% average total salary/career growth 2.60% inflation rate	

2018 Pension Payments By County ($ millions)

SERS pension payments positively impact the state's economy. In 2018, SERS made $3.4 billion in pension payments, nearly $3.1 billion went to Pennsylvania addresses.



$0 - $9.9 million | $10 - $24.9 million | $25 - $99.9 million | $100 million +

Out of State $317.0 million   Out of Country $1.6 million

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STATE EMPLOYEES' RETIREMENT SYSTEM

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01.26.2018

PENNSYLVANIA STATE EMPLOYEES' RETIREMENT SYSTEM

OPENING STATEMENT TO THE

PENNSYLVANIA HOUSE APPROPRATIONS COMMITTEE

TUESDAY, MARCH 5, 2019

Thank you, Mr. Chairman, and members of the Committee for inviting the State Employees' Retirement System here to discuss SERS' 2019-2020 budget request.

My name is Terri Sanchez, and I am the Executive Director of the State Employees' Retirement System. Joining me today is Mr. Bryan Lewis, Chief Investment Officer for the State Employees' Retirement System. Bryan has been with SERS since 2016. I have been with SERS since May of last year, and I can tell you that for SERS, it has been a time of tremendous change on many fronts.

The Pennsylvania State Employees' Retirement System currently serves approximately 240,000 active, inactive, vested and retired members. Last year, the system paid nearly $3.4 billion in benefits of which approximately $3.1 billion (approximately 91%) was issued to SERS members who live in Pennsylvania. For 2018, the average pension paid to retirees who work to full retirement age was about $28,880.

For FY 2019-20, we are seeking spending authority for $31.2 million from SERS funds, not general government operating accounts, and $3.8 million, which will be appropriated from non-SERS funds for the new Defined Contribution Plan.

Economic Volatility

Last year, 2018, provide to be a challenging year – particularly during the fourth quarter. At year-end 2018, SERS experienced an estimated investment loss of 4.3% due mainly to high market volatility. The impact was felt and shared around the world.

During 2018, the Dow Jones Average fell 5.6%. The S&P 500 was down 6.2% and the Nasdaq fell 3.9%. Globally, the FTSE All-World index, which tracks thousands of stocks across a range of markets, fell 11.3% in 2018. In short, it was a challenging year.

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One of the key reasons SERS has been able to continue paying promised benefits to its members – even in spite of profound economic challenges – is the fact that, for the past three years, the commonwealth has paid the actuarially required contribution to the fund. This was not always the case.

In the not-too-distant past, we saw first-hand, how persistent underfunding can jeopardize a plan's sustainability, eating away at the asset base, forcing decisions to liquidate investments at inopportune times, and pushing a retirement board to reach for returns that otherwise may not be needed, and which are often attained only through expensive investment alternatives.

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During 2018, SERS provided information and testimony to the Public Pension Management and Asset Investment Review Commission, created as a result of Act 2017-5 to study, identify and recommend ways the Commonwealth's public pension funds might improve their processes in regard to transparency, investment strategies and performance, stress testing and more.

The process was a very comprehensive and thought-provoking exercise for all concerned. We welcomed the opportunity to share our views on specific ways to reduce investment expenses and improve investment-related operations, as well as offer suggestions on how to achieve greater administrative efficiency and transparency without breaching our standard of care and fiduciary duties.

We were also heartened by the commission's final report, which, in addition to offering recommendations for further improvements, also praised SERS for our existing efforts aimed at cost savings – since 2010, we've reduced manager investment expenses by more than 50 basis points or $109 million. The commission also commended SERS for our use of rigorous benchmarking in our performance evaluations.

Currently, the SERS board, along with our staff, is reviewing more than 100 specific recommendations from the commission's final report. We look forward to working with the general assembly to review and act upon their recommendations.

Act 2017-5 also brought important changes to the retirement options for most new hires beginning January 1, 2019. For most new members, this legislation establishes two hybrid defined benefit/defined contribution options and a straight defined contribution plan. In addition to new hires, current members will have the opportunity to opt-in between January 1, 2019, and March 31, 2019. During the second half of 2018, SERS staff worked diligently to develop communications programs to educate members about their choices, and we continue to work with them to provide guidance and support as they make their selections.