Joint Committee on Pension Systems Review
February 8, 2017
Draft Bill Summary (Phase I)
Retirement System Funding and Administration Act

A. Funding of the Retirement Systems (SCRS and PORS):

1. The committee established the following as the order of the committee's top 3 pension funding priorities:
    a. Recognize and pay down deferred investment underperformance.
    b. Lower the assumed rate of return.
    c. Reduce the amortization period.
2. PEBA and GRS developed funding models based on the priorities established by the committee showing the minimum contribution increases necessary to both smooth in investment losses over 5 years and reduce the assumed rate of return to 7.25%. Models indicate that additional funding would be necessary to reduce the funding period to 20 years over the next 10 years.
3. Draft legislation includes the following statutory funding adjustments:
    1. Decouples employer/employee contributions to eliminate the required 2.9% differential between the two rates for SCRS, and the 5% differential between the two rates for PORS.
    2. Reduces the assumed annual rate of return from 7.5% to 7.25%. This is the rate recommended by GRS in its last experience study.
    3. Future changes to the assumed rate of return, beginning no later than FY 22, shall be recommended by PEBA. The General Assembly has the opportunity to disagree with PEBA's recommendation prior to a change in the rate taking place; however, if the General Assembly fails to enact a joint resolution that sets a different rate than recommended by PEBA, the submitted rate stands.
    4. Increases the employer contribution rate 2% effective July 1, 2017. (SCRS employer rate increases from 11.56% currently to 13.56%. PORS employer rate increases from 14.24% currently to 16.24%.) Each year thereafter, the rate increases 1%, through FY 23.
    5. Increases and <u>places a cap</u> on employee contribution rates for SCRS and PORS. (SCRS employee rate increases from 8.66% currently to 9%. PORS employee rate increases from 9.24% currently to 9.75%.)
    6. The total cost contemplated for both SCRS and PORS is <u>$73.6 M for FY 18</u>, and an additional <u>$36.8 M for each of the next 5 years</u>.
    7. Reduces the amortization period of unfunded liabilities from 30 years to 20 years over the next 10 years (by FY 28).
4. There is no reduction in the current COLA allowances.
5. By increasing the employer contribution rate by 2% in year 1 as compared to a 1% employer increase scenario, the funding period will be reduced an additional 3 years in the first year, and an additional $100 Million payment would be applied to the negative interest payment, which is currently approximately $220 M annually.
6. The scenario proposed assumes the assumed rate of return will be further reduced to 7.00% in FY 20.
7. Also, under the scenario proposed, PEBA and GRS project the negative interest will be eliminated by FY 22, and the funding period will be reduced to 20 years by FY 24.

B. **<u>Governance - Funston and LAC Recommendations:</u> The items included in the draft bill are drawn in large part from the governance recommendations made by Funston Advisory Services that require legislative action, and/or which were incorporated in bills passed by the Senate and the House during the last two-year session out of their respective bodies (S. 675 and H. 5006).**

1. PEBA Executive Director
   - Defines the roles and establish the authority of the Executive Director, designated by and who shall serve at the pleasure of the Board of Directors.
   - Clarifies the organizational structure of PEBA, such that all employees are hired by and report to the Executive Director.

2. PEBA Board of Directors
   - Extend terms for board members from two to five years (to match the RSIC), and impose term limits of two consecutive terms. (Members who will have served five years plus at the expiration of their current term may serve one additional term.)
   - Stagger term expirations such that the entire membership's terms do not expire at the same time.
   - Include diversity language for the new appointees.
   - Allow for members to be removed only for cause by the Governor. This is already in statute for RSIC commissioners.
   - Require that the board meet quarterly instead of monthly.
   - Board members and the Executive Director shall be named fiduciaries of PEBA, and imposes penalties for not fulfilling fiduciary responsibilities, identical to that already in statute for the RSIC.

3. RSIC Chief Executive Officer (CEO)
   - Defines the roles and establish the authority of the CEO, designated by and who shall serve at the pleasure of the Commission.
   - Clarify the organizational structure of the RSIC, such that all employees, including the Chief Investment Officer (CIO), report to the CEO.

4. RSIC Commission
   - Revises Commissioner's qualification requirements to allow for more diverse composition of members, including allowing for a mix of Commissioners with a significant amount of broad business experience and Commissioners with investment experience reliant on professional certifications. Includes diversity language for the new appointees.
   - Except for the Executive Director of PEBA, named officials associated with the membership of the commission shall have appointments to the commission, but may not serve in lieu of making an appointment.
   - Impose term limits for commissioners of two consecutive five-year terms. Members who are currently serving a second or greater term may not serve an additional term.
   - Allow the Commission to engage attorneys in consultation with the Attorney General (however, a formal approval letter by the AG would no longer be necessary) on a fee basis for investment and management of assets. The RSIC must

establish policies and procedures for the retention of attorneys and must provide notice to the AG of the terms and conditions of the retained attorney's representation as well as a quarterly report with fee and rate information specific to the retained attorney to the Attorney General. The Attorney General is required to monitor such fees for reasonableness and to ensure consistency with the terms and conditions of the representation.

- Add prohibitions regarding lobbyists, placement agents, and investments in which a commissioner has an interest.
- Adds 1 voting member per Funston recommendations to avoid a tie vote, increase beneficiary representation, and increase diversity.
  - There are currently 7 members: 6 voting members plus the Executive Director of PEBA, with no voting privileges.
- Requires the Treasurer to appoint a member rather than serve himself (identical to the other appointing officials).
- Remove the retired stakeholder appointed by the commission, and gives this appointment to the President Pro Tempore of the Senate.
- Adds an active stakeholder to be appointed by the Speaker of the House of Representatives.
- All members, except for the Executive Director of PEBA, must certify that they meet or exceed the qualifications set forth for commissioners by statute, and the appointing official must certify such qualifications to the Secretary of State. This certification process is the same as that for PEBA board members in statute.
- Includes fee reporting requirements.
- Includes permissive language allowing the commission to delegate to the CIO, under the direct oversight of the CEO, the authority to invest up to 2% of the assets of each investment. Such a delegation may be revoked by the Commission at any time.

5. PEBA and RSIC Fiduciary Audits
   - Set a 4-year rotation schedule for fiduciary audits of PEBA and RSIC.
   - The State Auditor will be the employing agency with a private audit firm (currently the State Inspector General).

6. Alignment of Governance Authority and Fiduciary Responsibilities
   - Simplifies and clarifies fiduciary governance by reducing conflicts and overlapping authority of the Treasurer, SFAA and PEBA.
     - SFAA approval is no longer required for the implementation of PEBA policy decisions.
     - Removes the Treasurer as the custodian of the 5 retirement systems (SCRS, PORS, JSRS, GARS and NGRS).
   - PEBA and the RSIC shall be co-trustees of the assets of the retirement system (SFAA is removed as a co-trustee).
   - The PEBA Board (not the Treasurer) shall be the custodian of the assets of the Retirement System.
   - The RSIC shall have the exclusive authority to select the custodial bank.
   - Includes minimum qualifications the custodial bank must meet before they are selected.