

Pennsylvania State Employees' Retirement System (SERS)

Governance

The SERS Board is an independent administrative board and consists of **11** members:

- Five gubernatorial appointees - One must be an annuitant
- Four legislators:
 - ✓ Two representatives appointed by the Speaker of the House (1 majority, 1 minority)
 - ✓ Two senators appointed by the President Pro Tempore (1 majority, 1 minority)
- State Treasurer (ex-officio)
- Secretary of Banking and Securities (ex-officio)
- Five board members must also be active members of SERS or active participants in the DC Plan, and two of them must have 10+ years of credited service in SERS or the DC Plan
- The Chair of the Board is appointed by the Governor

The Board has five standing committees:

- Audit, Risk & Compliance
- Board Governance & Personnel
- Finance and Member Services
- Investment
- Securities Litigation

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Governance *(cont.)*

- According to the State Employees' Retirement Code, board members have a fiduciary responsibility solely to SERS' members and are not to profit either directly or indirectly.
- The Board's fiduciary responsibility extends to the plan participants in the Deferred Compensation Plan and Defined Contribution Plan.
- The professional investment staff, external investment managers, and consultants also have a fiduciary responsibility to members and plan participants.

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Governance (cont.)

- The State Employees' Retirement Board hired Funston Advisory Services LLC in late 2015 to review its policies and governance structure to identify strengths, weaknesses, and areas for improvement.
- The review led to the issuance by Funston of a report dated March 4, 2016 (*For the Benefit of Pennsylvania: Strengthening SERS Oversight SERS Board and Organizational Structure Review: Final Report*), which resulted in the [SERS Board Governance Policy Manual](#).
- The Governance Policy Manual:
 - Contains the Bylaws, and 18 principal policies and procedures used by the Board and its committees in carrying out their fiduciary duties and responsibilities to the members of the SERS Defined Benefit Plan and plan participants of the Defined Contribution Plan and Deferred Compensation Plan;
 - Includes charters for each Board Committee and “position descriptions” for Board and Committee Chairpersons, Board and Committee Assistant Chair Positions, and Board Member Positions; and
 - Is available on the public website.

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Governance (cont.) – Recent Initiatives

■ SERS Strategic Planning Process

- The Board 's Strategic Planning Process requires the Board and SERS staff to engage in a robust and forward-looking strategic periodic planning process. In furtherance of the Strategic Planning Process, the Board approved at its September 30, 2020, meeting the [FY 2021-2023 SERS Strategic Business Plan](#).
- The Strategic Business Plan includes SERS Vision, Mission, Guiding Principles, and Strategic Priorities and Goals.
- The Board receives regular updates on the progress of the implementation of the plan's strategic goals and at the July 28, 2021, Board meeting approved an amendment to the plan.

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Governance (cont.)

▪ Fiduciary Review and Self-Assessment

- In support of the Board's Fiduciary Review Policy and Self-Assessment Policy, which both require periodic reviews of the Board's governance policies and practices, in January 2021, the Board again engaged Funston Advisory Services LLC to review the Board's fiduciary and governance practices in order to improve the effectiveness of the Board to better serve the needs of SERS' members and the Defined Contribution Plan and Deferred Compensation Plan participants, with corresponding benefits for the taxpayers of Pennsylvania.
- At the April 28, 2021, Board meeting, the Board accepted Funston's SERS Fiduciary Review and Board Self-Assessment – Final Report.
- The Board further directed SERS staff to engage with the appropriate standing committees of the Board to: (a) review the Final Report's recommendations, and (b) make recommendations to the Board for action, as appropriate.
- According to Funston's report, the Board made “significant improvements in its governance, structure, policies, and practices over the past five years since its last governance review.”
- SERS staff is working with the Board's committees in reviewing the report's recommendations.

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Investments

The objectives of the Defined Benefit Plan Fund are to provide benefit payments to participants and beneficiaries at the lowest cost to the commonwealth and to fund the program through a carefully planned and executed investment program.

SERS seeks to provide investment earnings that meet, or preferably exceed, the assumed rate of return over complete economic cycles. SERS strives to meet this objective by applying acceptable risk parameters and allocations to investments that are diversified by type, industry, quality, and geography. SERS' current target investment return is 7.0%.

The fund seeks to produce the highest return on investment that is consistent with acceptable investment risks while providing sufficient liquidity that will permit the fund to meet the system's benefit obligations. Work toward achieving investment objectives is guided by *SERS' Defined Benefit Plan Investment Policy Statement*.

Returns as of June 30, 2021, net of fees, annualized

	1-YR	3-YRS	5-YRS	7-YRS	10-YRS	15-YRS	20-YRS	25-YRS
SERS' Total Fund	27.8%	11.0%	10.7%	7.9%	8.3%	6.7%	7.1%	8.0%
60/40 Index	22.9%	10.9%	10.0%	7.2%	7.4%	6.6%	6.6%	6.7%

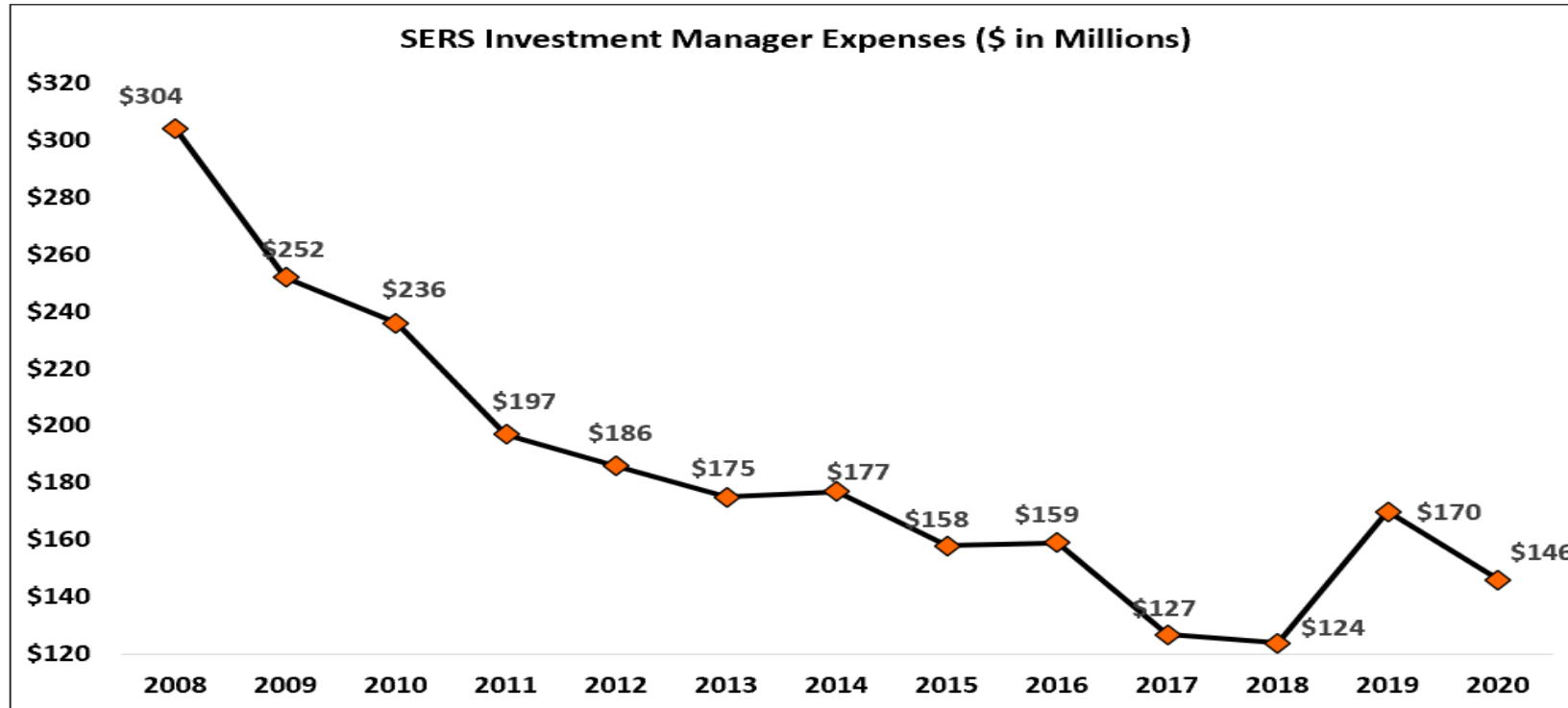
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Manager Fees and Expenses

- SERS strives to engage the highest quality investment managers for the most cost-effective price.
- SERS reports its performance net of manager fees for public market managers and net of fees and expenses for its private market managers.
- Since 2008, SERS has worked to reduce investment manager fees and expenses year over year by approximately half from \$304 million in 2008 to \$146 million in 2020.
- SERS continues to negotiate aggressively for more favorable fee structures with new as well as existing investment managers.
- SERS is including commitments to side-car investments as well as co-investments in both private equity and real estate.
- SERS has increased use of index funds in lieu of active management.

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Manager Fees and Expenses (cont.)



2019 fees include \$19 million in incentive fees that were earned over a multi-year period but recorded in the current year (~0.06% of the total fund assets).

Sources: 2014-2020 from SERS' Annual Comprehensive Financial Reports. 2008-2013 from SERS' Budget Books. In 2014, SERS included and started to report other investment-related expenses reported in the 2008-2013 ACFRs into the investment manager expense.

House State Government Committee

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Transparency

SERS has an ongoing commitment to demonstrate transparency, while working within its legal and fiduciary framework.

- All new investment managers are required to provide SERS with the information found within the Institutional Limited Partners Association's (ILPA) Reporting Template. All current managers have been asked to provide SERS with the information found in the ILPA template.
- Beginning with the quarterly performance report of Q1 2020, SERS reports investment performance on a gross and net of fee basis.
- Since December 2019, SERS has posted to its website, public versions of prospective managers' pitch book materials and staff/consultant memos recommending the investment opportunity, for investments considered by SERS.
- Beginning with the period ending June 30, 2019, SERS began posting public versions of the semi-annual performance reports of its specialty consultants (private equity and real estate).

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Transparency (*cont.*)

- SERS' Office of Financial Management and the Investment Office provided an annual report of all 2019 investment fees and expenses (including carried interest) to the IC at the September 2020 meeting and subsequently posted this report on SERS' website.
- SERS' Chief Counsel Office (CCO) and the Investment Office compiled an annual report on public manager contracts, which identifies changing terms. The first report covered the CY 2020.
- SERS will compile an annual report (beginning with FY 20/21) disclosing all travel and other expenses incurred by investment professional staff and paid for by external investment managers, funds, and/or consultants as well as the expenses incurred by SERS.

Pennsylvania State Employees' Retirement System (SERS)

Financial Overview

- SERS was established in 1923 and is one of the nation's oldest and largest statewide retirement plans for public employees.
- SERS operates three plans. The **Defined Benefit Plan** and the **Defined Contribution Plan** are mandatory for most employees. A third plan – the **Deferred Compensation Plan**, is a voluntary supplemental plan.
- The plans had \$35.0 billion, \$40.5 million and \$4.4 billion of net assets, respectively, as of SERS' most recent fiscal year-end date of December 31, 2020.

Defined Benefit Funding:

- SERS Defined Benefit Plan is funded through three sources:
 - Member Contributions
 - Investment Earnings
 - Employer Contributions
- Over the past 25 years, 65% of the fund's revenue came from investment earnings, 24% came from employer contributions, and 11% from member contributions.

Pennsylvania State Employees' Retirement System (SERS)

Financial Overview (cont.)

- SERS current Unfunded Actuarial Liability is \$22.4 billion, and the funded ratio is 59.4%

Valuation Year Ended December 31	Funded Status (\$ in thousands)			
	Actuarial Value of Assets	Actuarial Accrued Liabilities	Unfunded Actuarial Accrued Liability	Funded Ratio
2020	\$ 32,703,275	\$ 55,098,758	\$ 22,395,483	59.40%
2019	\$ 29,934,024	\$ 52,972,575	\$ 23,038,551	56.50%
2018	\$ 28,989,607	\$ 51,782,205	\$ 22,792,598	56.00%
2017	\$ 28,776,939	\$ 48,439,403	\$ 19,662,464	59.40%
2016	\$ 27,596,048	\$ 47,518,964	\$ 19,922,916	58.10%
2015	\$ 26,877,127	\$ 46,328,929	\$ 19,451,802	58.00%
2014	\$ 26,584,948	\$ 44,750,670	\$ 18,165,722	59.40%
2013	\$ 25,975,185	\$ 43,874,580	\$ 17,899,395	59.20%
2012	\$ 25,302,688	\$ 43,055,564	\$ 17,752,876	58.80%
2011	\$ 27,618,461	\$ 42,281,862	\$ 14,663,401	65.30%

NOTE - 2020 includes one-time lump sum payment towards UAL from PSU

Pennsylvania State Employees' Retirement System (SERS)

Financial Overview *(cont.)*

■ Factors Influencing the Unfunded Actuarial Liability

- Sustained periods of employer contributions below normal costs: 1992 through 2009, and the associated loss of compound returns
- Losses that neutralized investment gains: -10.9% in 2002 and -28.7% in 2008
- Benefit increases that were not pre-funded – including increased accrual rates and cost of living adjustments: Act 2001-9 and Act 2002-38
- Legislatively mandated actuarial changes that extended the time over which liabilities be paid or artificially suppressed employer contribution rates: Act 2003-40 and Act 2010-120
- Gradual reductions in assumed rates of return over the past several years, from 8.5% in 2008 to 7.0% effective with the December 31, 2020, actuarial valuation to reflect changing market conditions

Pennsylvania State Employees' Retirement System (SERS)

Financial Overview (cont.)

■ Looking Forward

- In recent years employers made considerable progress restoring funding to their employees' pensions. These steadily increased contributions supplemented by strong investment returns, despite turbulent market conditions over the past several years, are working to steadily strengthen the health of the fund.
- Additionally, the annual cost of the plan continues to drop, in response to legislative reforms, as the number of members in Act 120-2010 classes of service, and the newer Act 5 classes of service that opened Jan. 1, 2019, increases. At the end of 2020, approximately 45% of the active membership were in these new classes of service.

Projections of Key Actuarial Data

Valuation Year Ended Dec 31	Funded Ratio	UAL	For FY Beginning July 1 Following Valuation Year (\$ in billions)			
			Employer Normal Cost Rate	Unfunded Liability Rate	Employer Contribution Rate	Employer Contributions
2021	67.2%	\$ 17.22	8.29%	26.22%	34.51%	\$ 2.20
2022	69.1%	\$ 16.44	8.12%	25.10%	33.22%	\$ 2.18
2023	72.3%	\$ 14.93	7.96%	23.24%	31.20%	\$ 2.10
2024	74.3%	\$ 14.02	7.81%	22.13%	29.94%	\$ 2.07
2025	75.6%	\$ 13.44	7.66%	21.44%	29.10%	\$ 2.06
2026	76.9%	\$ 12.85	7.53%	20.79%	28.32%	\$ 2.06
2027	78.2%	\$ 12.25	7.40%	20.19%	27.59%	\$ 2.07
2028	79.4%	\$ 11.63	7.27%	19.63%	26.90%	\$ 2.07
2029	80.7%	\$ 10.98	7.15%	19.09%	26.24%	\$ 2.08
2030	82.0%	\$ 10.29	7.04%	18.56%	25.60%	\$ 2.10

NOTE - Projections include impacts of PSU and PASSHE one-time lump sum payments.

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Financial Overview (cont.)

Stress Testing and Risk Assessment

- Beginning in 2019, SERS worked with its actuary to produce a *Stress Testing and Risk Assessment* report, which identifies and assesses major factors that contribute to the risk that the actual future value of benefits paid from the SERS Defined Benefit Plan will differ from the estimated value provided by the annual actuarial valuation and the actuarially determined contributions. It includes an analysis of various “What if?” scenarios to determine the effect on future employer contributions and the availability of assets to pay benefits when due to members.
- According to The PEW Charitable Trust, overall, the SERS report was a leading example of pension stress test analysis that provides policymakers and budget officials with accessible information about the impact of investment risk on government budgets and contribution risk on pension balance sheets.

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Pension Forfeiture

Public pension forfeiture in Pennsylvania is governed by state law. There are two types of public pension forfeitures and sources of forfeiture law:

- Act 140 of 1978, as amended (“Act 140”), governs forfeitures of pensions for state employees specifically and all public employees in Pennsylvania generally. Act 140 forfeitures are triggered by criminal conduct.
- The Pennsylvania Constitution and the Pennsylvania Judicial Code contain specific provisions for the forfeiture of pensions for members of the Judiciary. These forfeitures are triggered by removal from judicial office. A judge can be subject to forfeitures under both Act 140 and the judicial forfeiture provisions.

Note: The list of crimes that trigger Act 140 pension forfeitures is statutorily defined. The Courts have ruled that SERS and the other pension administrators have no discretion to waive the application of Act 140.

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Pension Forfeiture (Cont.)

- Act 140 has *three elements* that must be satisfied to trigger a pension forfeiture:
 - 1) a public official or public employee;
 - 2) is convicted of (or after Act 2019-1 is found guilty of) or pleads guilty or no defense to a crime listed in Act 140; and
 - 3) the crime was committed *through the public office or position or when the public office or position put the public official or employee in a position to commit the crime.*
- Act 2019-01 amended Act 140 to expand the list of forfeiture crimes that require pension forfeiture to include most job-related Pennsylvania felonies and made other administrative changes. The amendments apply only to crimes committed on or after March 28, 2019.