EMPLOYER bulletin
February/March 2009 Publication #9194

Important Update for School Employers From PSERS' Executive Director

As many of you know, each year PSERS' Board of Trustees reviews the Fund's actuarial assumptions with its actuaries, including the investment rate of return assumption, and decides whether or not to make any changes to the assumptions going forward. The investment rate of return assumption is used to structure the asset allocation of the Fund. Changing this assumption affects PSERS' long-term funding requirements and ultimately impacts the Fund's exposure to risk and volatility in the investment markets. While PSERS has traditionally taken a long-term perspective on its investment return assumption, the extent, speed and global nature of the current market downturn appears to be historic and is an indicator of a turning point for the U.S. and global economy. Moreover, since PSERS' 8.5% return assumption is one of the highest investment rate of return assumptions among public pension funds in the country, the PSERS' Board decided to act.

This year, as PSERS' Board of Trustees reviewed the investment rate of return assumption and the current impact of the economic downturn on the Fund, it became apparent PSERS' long-term investment returns would continue to decline. Indeed, as of December 31, 2008, PSERS' one, three, five, and ten-year average investment rates of return fell well below PSERS' long standing 8.50% investment return assumption. If the downturn in the investment markets continues, PSERS expects its long-term returns to decrease further below the assumption.

Therefore, at their Board Meeting on Friday, January 23, 2009, PSERS' Board of Trustees voted to decrease the actuarial investment rate of return assumption from 8.50% to 8.25% effective for the June 30, 2008, actuarial valuation. The Board of Trustees also voted to decrease the rate of return assumption further from 8.25% to 8.00% for the June 30, 2009, actuarial valuation. The changes made by the Board lower PSERS' rate of return assumption to the median investment rate of return assumption used by most public pension funds and provide a more realistic projection of future investment returns of the Fund.

These changes also marginally reverse Act 40's artificial suppression of the employer contribution rate below the normal cost notwithstanding the large unfunded liability and result in some pre-payment of the unfunded liability before the FY 2012/2013 rate spike.

The employer contribution rate of 4.78% for FY 2009/2010 <u>will not</u> be affected by the change in the investment rate of return assumption.

Employer Contact Information

Toll-Free: (888) 773-7748
FAX: (717) 783-8760

Employer Service Center Staff

Eloine Bolton
(717) 720-6320
ebolton@state.pa.us
Adams, Cumberland, Dauphin, Franklin, Fulton, Huntington, Juniata, Lackawanna, Lancaster, Lebanon, Luzerne, Mifflin, Monroe, Northampton, Perry, Pike, Susquehanna, Wayne, Wyoming, and York Counties

Rose Diehl
(717) 720-6323
rosdiehl@state.pa.us
Beaver, Bradford, Butler, Cameron, Centre, Clarion, Clearfield, Clinton, Columbia, Crawford, Elk, Erie, Forest, Jefferson, Lawrence, Lycoming, Mercer, McKean, Montour, Northumberland, Potter, Schuylkill, Snyder, Sullivan, Tioga, Union, Venango, and Warren Counties

Ellen Harrington
(717) 720-6321
eharringto@state.pa.us
Charter Schools and Philadelphia School District

Loralie Rebuck
(717) 720-6326
lrebuck@state.pa.us
Berks, Bucks, Carbon, Chester, Delaware, Lehigh, Montgomery, and Philadelphia Counties (except Philadelphia School District)

Sandra Shabazz
(717) 720-6324
sshabazz@state.pa.us
Allegheny, Armstrong, Bedford, Blair, Cambria, Fayette, Greene, Indiana, Somerset, Washington, and Westmoreland Counties

Important Update continuation...

Lowering the investment rate of return assumption is an important step for the Fund because it provides additional transparency about PSERS' funded status and more accurately reflects the projected investment environment. The additional transparency will provide a much clearer picture for future legislative efforts to resolve the projected employer contribution rate spike in FY 2012/2013.

While the FY 2009/2010 employer contribution rate is not affected, PSERS' funded status and the projected rate spike in FY 2012/2013, however, are affected by the decrease in the investment rate of return assumption. PSERS' funded status was 86.0% as of June 30, 2008, up from 85.8% as of June 30, 2007.

In addition, based on the changes made at the Board meeting, the estimated FY 2012/2013 employer contribution rate spike is 20.16% (based on the June 30, 2008 actuarial valuation) which is an increase from the most recent estimate of 16.40%. A spreadsheet showing the new 30-year projections of the employer contribution rate is included in this publication.

The projected employer contribution rate spike of 20.16% in FY 2012/2013 is currently still below the original rate spike of 27.73% as projected in FY 2003. The downturn in the economy, however, continues to negatively impact the Fund. In the past, PSERS' investment staff had made significant progress to decrease the projected spike, dropping the original rate spike to 11.23% as of the June 30, 2007, valuation. Over the past few months, the sharp downturn in the economy has essentially eliminated any past progress made in reducing the rate spike. While a few months remain until the end of PSERS' fiscal year on June 30th, the investment losses the Fund has experienced to date will be difficult to overcome. For the fiscal year, the S&P 500 Index is down 29.43% and the Dow Jones Industrial Average is down 22.68%. PSERS' investment losses could reach similar levels if the markets do not begin to recover by the end of the current fiscal year. When those potential losses are factored into future rate spike projections, the rate spike could exceed the original projection of 27.73%.

I realize these numbers are difficult, if not impossible, to prepare for in your future budgets. That said, it would be irresponsible not to give you the most accurate picture of the Fund, so that everyone is aware of the difficult situation facing school employers, Commonwealth taxpayers, and PSERS in the coming years.

There are options to address the projected rate spike but there is no silver bullet. Under all such options, however, there will still be a need for significant additional funding to PSERS. As in the past, PSERS is committed to providing assistance to the General Assembly to solve the projected rate spike and future funding issues of the System.

In conclusion, I will continue to keep you apprised of the situation as PSERS moves closer to its fiscal year end.

Sincerely,

Jeffrey B. Clay
Executive Director