FY 2024-25 Employer Contribution Rate – Frequently Asked Questions

What is the FY 2024-25 Employer Contribution Rate?

On December 15, 2023, the Public School Employees' Retirement System (PSERS) Board of Trustees certified the FY 2024-25 employer contribution rate (ECR) at 33.90%. The ECR is the percentage of payroll that local school employers and the Commonwealth share and pay toward retired and current school employees' benefits.

The 33.90% ECR represents the second year-to-year decline for school employers and the Commonwealth in more than a decade.

- The FY 2024-25 ECR is 0.29% lower than the current FY 2024-25 rate of 34.00%.
- Despite the slightly lower rate, higher than expected payroll growth will cause total employer contributions projections to rise by $ 96.6 million ($5.29 billion) in FY 2024-25 compared to FY 2023-24 ($5.19 billion).
- School boards set their budgets based on the ECR percentage rate, and a lower ECR will equal real multi-year budgetary savings for their local taxpayers.

Why did the FY 2024-25 Employer Contribution Rate decrease when the Fund did not meet its 7.00% investment rate of return in FY 2022-23?

The ECR decrease, the second since 2008-09, was caused in large part by PSERS' employers strong payroll growth and favorable demographic changes involving mortality and retirement experience, according to the Board's actuarial firm, Buck Global LLC. The Public School Employees' Retirement Code mandates the Board to adopt an employer contribution rate that is calculated in accordance with statutory formula and certified by the actuary.

The payroll growth and demographic factors, coupled with sustained actuarial ECR funding, contributed to a $1.6 billion decrease in the System's long-term unfunded actuarial liability ($42.3 billion). It is the largest 1-year decline since 2006-07. Put more simply, while the rate has decreased, the total dollar value paid against the liability has increased largely due to higher than expected payroll growth.

- The ECR is made up of several actuarial components, not just net investment returns. Other components impact the ECR, including school employer payroll, demographic factors such as mortality, and projections of retirements and terminations.
- All components, including net investment gains and losses, are amortized over 24 years per Act 120 of 2010.
- Net investment gains and losses are also subject to another actuarial method known as "smoothing."
    - Under Act 120 of 2010, annual net investment returns are actuarially smoothed into the Fund over a decade or in 1/10th increments per year. The smoothing process means PSERS annual net returns, whether negative (such as the years impacted by

the Great Recession) or positive (such as FY 2021's 24.58%) are recognized slowly over time (currently 10 years).

- This smoothing helps to stabilize the budgeting process for school employers and the Commonwealth, which could otherwise vary widely from year to year if recognized immediately. The investment return impact to the ECR is recognized over 10 years since investment returns over 10-year periods are historically much less volatile than one-year returns. By comparison, payroll and demographic changes do not have smoothing factors – and all of their year-to-year changes are immediately factored into the total pension liability and impacts the 24-year amortization of unfunded liability used to set next year's ECR.

What does this mean for the future?

- The decline in the FY 2024-25 ECR is a one-year decline, and ECR rates could rise again slowly. Future increases, however, will start from the lower FY 2024-25 base ECR of 33.90%. This means projected ECR increases are expected to remain lower than previous projections over the next few years.
- The System's funded ratio is expected to reach 81.9% in FY 2032 as more workers who join the System do so under the reduced retirement benefit structures enacted by Act 120 of 2010 and Act 5 of 2017 and full annual funding continues to reduce the unfunded liability.
- Full annual funding since July 1, 2016, favorable long-term investment returns, and a declining cost of current benefits continue to make a positive difference on the financial health of PSERS.

How does smoothing work in practice?

Page 17 of PSERS June 30, 2023, Valuation presentation (pictured below) shows total net investment gains/losses are "recognized" in (1/10th increments) over 10 years. For instance, the 2013-14 gain has been fully recognized over the last decade while the 2022-23 loss is in its first year of being recognized.

By adding and subtracting all values in the recognized column, the actuary calculated a total investment loss of $352 million for the 2022-23 fiscal year valuation.

Actuarial Value of Assets
Ten-year asset smoothing method

1. Market value of assets June 30, 2023 — $ 72.253 Bil

2. Determination of deferred gain (loss)

Fiscal Year	Gain (Loss)	Recognized Amount – FY22/23	Percent Deferred	Deferred Amount
2022/2023	$ (2.160) Bil	$ (0.216) Bil	90.00 %	$ (1.943) Bil
2021/2022	(4.985)	(0.499)	80.00	(3.988)
2020/2021	10.116	1.012	70.00	7.081
2019/2020	(3.440)	(0.344)	60.00	(2.064)
2018/2019	(0.600)	(0.060)	50.00	(0.300)
2017/2018	0.551	0.055	40.00	0.220
2016/2017	0.847	0.085	30.00	0.254
2015/2016	(3.794)	(0.379)	20.00	(0.759)
2014/2015	(2.918)	(0.292)	10.00	(0.292)
2013/2014	2.864	0.286	0.00	0.000
	$ (3.519) Bil	$ (0.352) Bil		$ (1.791) Bil

3. Preliminary actuarial value of assets June 30, 2023: (1) – (2) — $ 74.044 Bil

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How does smoothing impact other ECR components?

Only the investment losses/gains are the only EXCR component that is smoothed over 10 years. That means the total financial impacts of the other component are reflected in the total pension liability and fully impact the calculation of the next year's ECR as depicted on page 25 PSERS June 30, 2023, Valuation.

- Line 1 shows the negative smoothed investment loss of $352 million.
- Line 2 shows the positive and negative effects of five demographic that total $602 million.
- Line 3 shows positive stronger than expected contributions of $359 million.
- Line 4 shows a positive net actuarial gain of $609 million.

2023 Net Actuarial Gain

1.	Investment return loss[1]	$	352 Mil
2.	Accrued liability experience (gains) and losses[2]		
	- New entrants, pickups, and rehires		351
	- Individual salary increases		(599)
	- Mortality		(46)
	- Retirement/disability/terminations		(207)
	- Miscellaneous		(101)
	- Total	$	(602) Mil
3.	Actual contributions greater than expected	$	(359) Mil
4.	Net actuarial experience gain: (1) + (2) + (3)	$	(609) Mil

1. 6.50% actual rate of return on the Actuarial Value of Assets vs. the assumed 7.00% rate of return.
2. Experience (gains) reduce the System's unfunded accrued liability and experience losses increase the System's unfunded accrued liability.

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