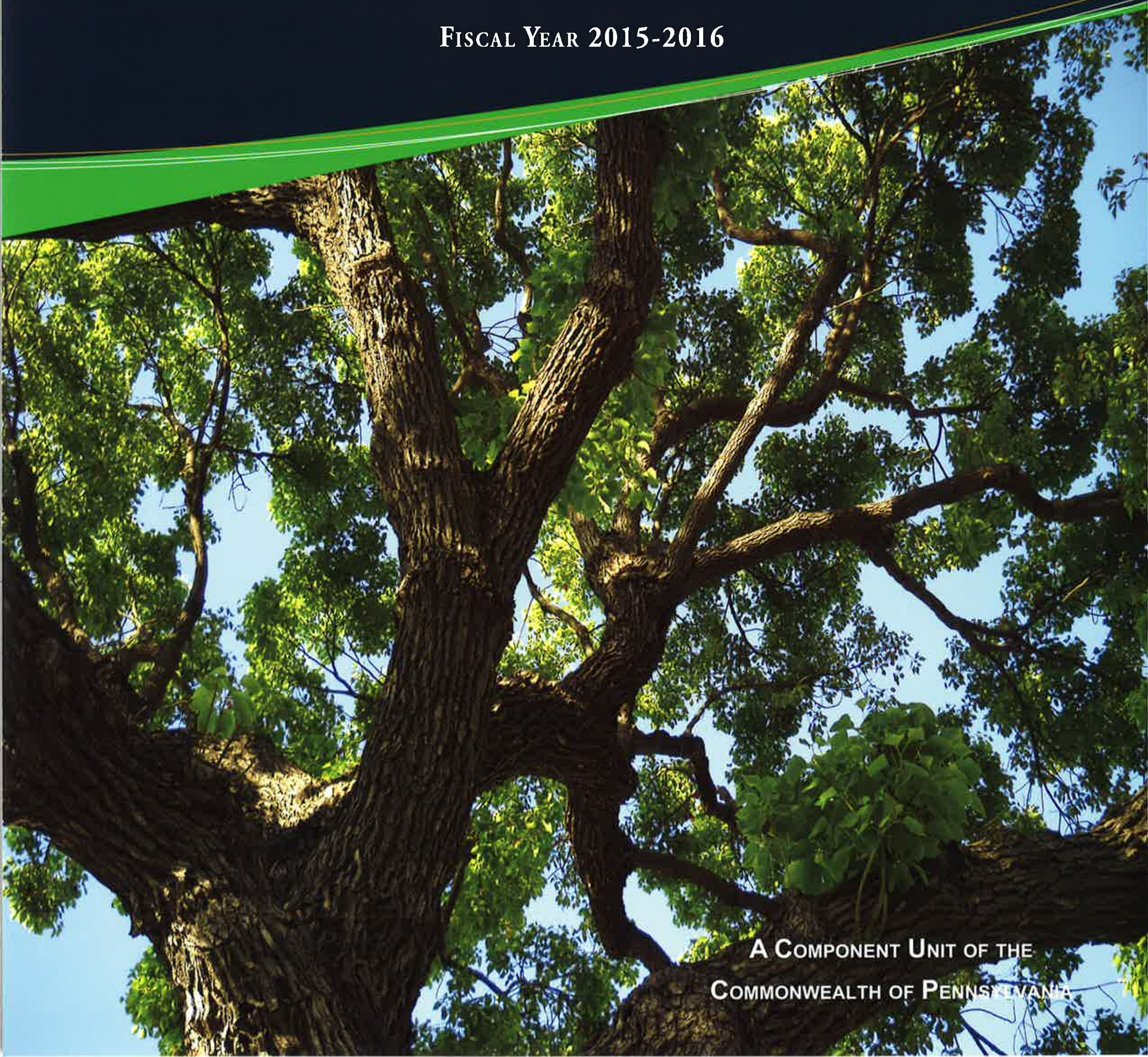
Pennsylvania Public School Employees' Retirement System

Budget Report

House Appropriations Committee

Fiscal Year 2015-2016



A Component Unit of the
Commonwealth of Pennsylvania

COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT BOARD

March 13, 2015

Members of the House Appropriations Committee

Dear Members:

On behalf of the Public School Employees' Retirement System (PSERS, System, or Fund), I am pleased to present the accompanying report on the financial, actuarial, and investment operations of PSERS and the budgetary recommendations for the 2015/16 fiscal year. Copies of this document and PSERS' Comprehensive Annual Financial Report for the fiscal year ended June 30, 2014 (FY2014) are available for download from PSERS' website at www.psers.state.pa.us/publications. Hard copies and CDs are also available upon request.

PSERS is responsible for administering a defined benefit pension plan for nearly 500,000 active, retired, and vested public school employees in the Commonwealth of Pennsylvania. PSERS also administers two post-employment health care programs, the Premium Assistance Program and the Health Options Program (HOP) for its annuitants.

Some key highlights about PSERS follow:

- PSERS continues to be prudent in its use of funds and managing its annual budget. PSERS' Budget Request and the Governor's Recommended Budget for FY2015/16 was $43,777,000. Each year PSERS participates in an international benchmarking survey evaluating its benefit administration costs and service performance in comparison to other similar public pension funds. Based on the FY2013 survey, PSERS had a 22% lower pension administration cost per member than the average cost for its peer group while experiencing a 17% higher transactional volume per full time equivalent than its peers.

- Member contributions currently range from 5.25% to 10.30% of payroll depending on the class of membership of the employee and when they joined PSERS. Members are projected to contribute an average of 7.49% of their salary towards their retirement benefit in fiscal year 2015/16. Member contributions of approximately $1.0 billion are expected in fiscal year 2015/16. In addition, Act 120 members hired after June 30, 2011, also share some of the investment risk via the shared risk program and will contribute at a higher contribution rate if the Fund underperforms the benchmark established by Act 120.

- The average annual pension benefit for PSERS' total member population (annuitant, survivor/ beneficiaries, and disabled annuitants) as of June 30, 2014 is $24,962 and the average age is 70.2 years. In FY2014, PSERS provided $6.1 billion in pension and healthcare benefits to its members. Since approximately 90% was distributed to Commonwealth residents in calendar year 2014, a substantial portion of PSERS' $6.1 billion annual pension disbursements remain in Pennsylvania, benefiting the economy of the Commonwealth.

- Investment earnings are the largest source of funding for PSERS. Income from PSERS' investment portfolio accounts for nearly 71% of total revenues over the 20-year period from FY1995 to FY2014. For the fiscal year ended June 30, 2014 PSERS' investment portfolio generated a rate of return of 14.91%. PSERS' return exceeded the investment earnings assumption of 7.50% and added $7.1 billion in net investment income to the Fund. The most recent actuarial valuation as of June 30, 2014 reports that PSERS is 62.0% funded. Total plan net assets were $53.3 billion as of June 30, 2014.

- For the calendar year ended December 31, 2014 PSERS earned 8.83% and added $4.2 billion in net investment income. Total plan net assets were $51.7 billion. Additional detailed investment performance information is located on the Investment Program page of PSERS' website.

Investment Management Fees and Indexing

- On March 3, 2015, Governor Wolf presented his proposed budget. In his remarks the Governor raised the issue of eliminating wasteful expenditures on Wall Street managers and increasing the use of index funds to create savings for PSERS. To date, PSERS has not met with the Governor or the Administration on this proposal. PSERS remains open to reviewing all concepts for potential cost savings at the System. In particular, PSERS staff welcomes the opportunity to meet with the Governor and his Administration to gain a more detailed understanding of his proposal for PSERS' investment manager fees and indexing.

- While PSERS is supportive of identifying potential cost savings, it is imperative that the investment management fee and indexing concept is studied thoroughly before any action is taken to prevent any negative impact on the System or the Commonwealth and school employers. As fiduciaries and investment experts, PSERS' Board and staff are aware of both investment return expectations and investment manager fees. PSERS also has other obligations to balance when investing PSERS' assets which include monitoring investment risk and diversification, and cash flow needs as the System continues to be underfunded by the Commonwealth and school employers.

- PSERS remains open and transparent regarding investment management fees paid and the value PSERS received for those fees. To the extent that any active manager is not performing up to expectations, they are terminated. PSERS is continually evaluating and managing its investment portfolio based on market conditions. For example, 15 years ago the Fund was primarily active in the implementation of its U.S. equity allocation. Today, PSERS almost entirely manages that allocation internally using passive indexes.

- PSERS' philosophy is to use indexes in those asset classes where the investment staff does not believe they can find active managers who can beat the passive indexes on a net of fee basis. As of December 31, 2014, PSERS had over $10 billion in exposure, or approximately 20% of its portfolio, to passive indexes managed internally by PSERS' investment staff.

- Over the last 15 fiscal years PSERS earned a net profit of an additional $11.46 billion over and above what PSERS would have earned if the investment staff had just passively indexed the investment portfolio simply to save on fees.

Update on Employer Contribution Rate and Funding Issue

- On March 3, 2015, Governor Wolf in his remarks proposed a $3 billion cash infusion that would have an immediate effect on the unfunded liability of the System, and save the Commonwealth and school districts nearly $8 billion over the next 24 years. Governor Wolf also suggested that all future Commonwealth contributions be placed into a restricted account to improve controls over the funding stream.

- Act 120 of 2010 is working as expected and has increased funding to the System by steadily increasing the employer contributions towards meeting the annual required contribution amount. It has significantly reduced benefit costs for all new members joining the System and has shifted some of the investment risk to new members. As of June 30, 2014 approximately 38,000 or 14% of PSERS active membership is under the new reduced benefit structure of Act 120. The employer annual benefit cost for new members joining the System is less than 3%. As the Act 120 membership grows, the annual savings from the lower Act 120 benefit cost structure will allow an increasing amount of employer contributions to pay down PSERS' existing unfunded liability. An estimated $103 million is expected in annual savings during FY2015/16 from the reduced cost of the Act 120 benefit tiers.

• Pension reform enacted under Act 120 of 2010 is well underway. The rate collars continue to gradually increase the employer contribution rate closer to the actuarially required rate. The employer contribution rate for FY2015/16, set by PSERS' Board in December 2014, is 25.84% or the equivalent of approximately $3.45 billion in contributions. The rate collars established under Act 120 of 2010 remain in effect for a fifth year and continue to suppress the pension rate and underfund the System. FY2015/16 would be the last fiscal year, based on current actuarial projections, the rate collars will be in place as the FY2016/17 employer contribution rate is projected to increase by less than the Act 120 rate collar.

• The employer contribution rate continues to increase to the actuarially-required level necessary to begin making payments on the principal and pay down existing debt for prior service. The majority of the employer contribution rate for FY2015/16 represents the cost of interest on the unfunded liability.

While difficult budget issues remain for both the Commonwealth and school employers, a number of funding projections have improved over the past fiscal year, including:

- Total employer contribution dollars through FY2047 are projected to decrease by $13.7 billion due to PSERS strong FY2014 investment performance and lower employer payroll.

- The pension debt, or the unfunded accrued liability (UAL) as of June 30, 2014, is $500 million less than projected one year ago due to PSERS' strong FY2014 investment performance and lower employer payroll. It was projected at $35.6 billion but decreased to $35.1 billion.

- The peak UAL dollar amount projected for FY2018 is over $2 billion less than what was projected last fiscal year. The peak amount decreased from $45.1 billion to $42.9 billion.

- The annual employer cost of benefits for current service (the employer normal cost) continues to decrease. It decreased from 8.66% in FY2012/13 to 8.38% in FY2015/16, as more new members join the system under the reduced benefit cost structure of Act 120 of 2010. It is projected to be less than 3% once all members are under the Act 120 benefit structure.

In closing, PSERS will continue to cooperate with the General Assembly in its role as a technical expert in providing fact-based information to support efforts in determining effective pension policy. And, as in the past, PSERS will assist in drafting technically correct provisions while remaining policy neutral on legislative proposals. PSERS looks forward to working with you on this critical appropriation issue during the current legislative session. Please contact PSERS Executive Office, if you have any questions or would like additional information.

Respectfully,

Melva S. Vogler

Melva S. Vogler
Chairman of the Board

Pennsylvania
Public School Employees' Retirement System

(A Component Unit of the Commonwealth of Pennsylvania)

5 North 5th Street
Harrisburg, Pennsylvania 17101-1905

FY2015/16 Budget Report
House Appropriations Committee
March 23, 2015

Melva S. Vogler
Chairman
Board of Trustees

James M. Sando
Vice Chairman
Board of Trustees

Jeffrey B. Clay
Executive Director

Report prepared by the Public School Employees' Retirement System
Office of Financial Management staff

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Overview

Established on July 18, 1917, with operations commencing in 1919, the Pennsylvania Public School Employees' Retirement System (PSERS, System or Fund) provides retirement benefits to public school employees of the Commonwealth of Pennsylvania.

As of June 30, 2014, the System had approximately 263,000 active members. The annuitant membership was comprised of approximately 214,000 retirees and beneficiaries who received average monthly pension benefit payments of over $450 million including healthcare premium assistance. The average yearly pension benefit paid to annuitants was $24,962. PSERS had 789 participating employers on June 30, 2014.

As reported in the latest Pension and Investments survey, published February 9, 2015, PSERS is the 30th largest plan among United States corporate and public pension plans, and the 20th largest state-sponsored defined benefit public pension fund in the nation. PSERS' total plan net assets as of December 31, 2014 were approximately $51.7 billion.

During calendar year 2014, PSERS pension disbursements to retirees totaled $6.1 billion. Of this amount, 90% was distributed to Pennsylvania residents representing PSERS' significant impact on the Commonwealth's economy.

Mission Statement

The Board of Trustees and the employees of the Public School Employees' Retirement System serve the members and stakeholders of the System by:

- Providing timely and accurate payment of benefits,
- Maintaining a financially sound System,
- Prudently investing the assets of the System,
- Clearly communicating members' and employers' rights and responsibilities, and
- Effectively managing the resources of the System.

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PSERS Board of Trustees

PSERS Board Members as of February 10, 2015

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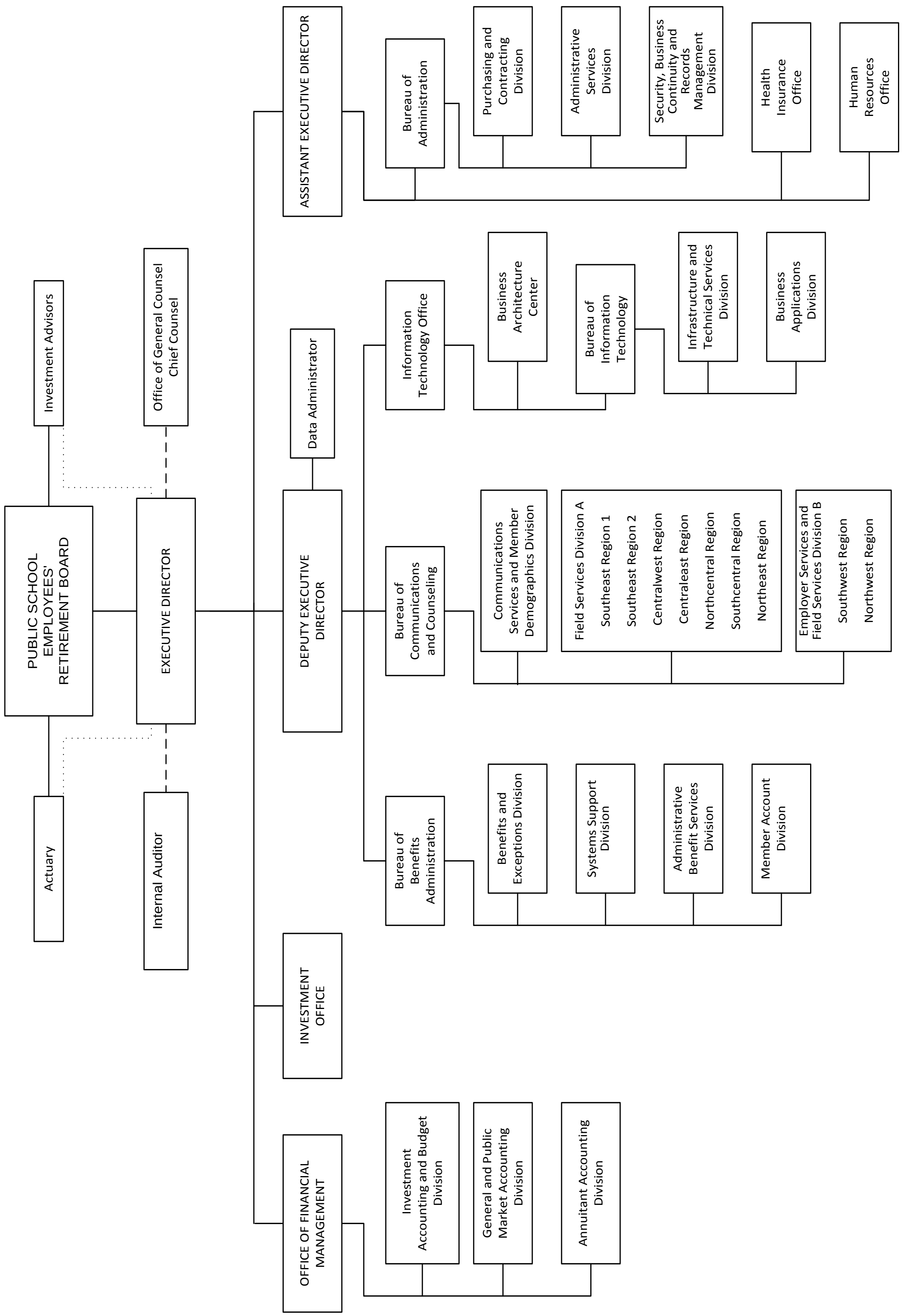
Organizational Chart of the Public School Employees' Retirement System



Organizational Structure of the Public School Employees' Retirement System

Executive Office

This office is responsible for the overall management of the Public School Employees' Retirement System (PSERS) to achieve the primary objectives of the Fund as established by the Board of Trustees (Board). Reporting directly to the Executive Director is the Deputy Executive Director, Assistant Executive Director, Chief Investment Officer, Chief Financial Officer, Internal Auditor, Press Secretary, Board Liaison, and Legislative Liaison. The Executive Director serves as chief executive officer responsible for the establishment, installation, and maintenance of modern management techniques to provide an efficient control of funds for and services to the active members and annuitants of the System.

The Executive Office monitors the operation of the investment portfolio and evaluates portfolio performance for consideration by the Board, certifies expenditures of the Fund and measures performance of professional individuals or firms with whom the Board contracts for specialized services. The Executive Office also apprises the Board of any development that will in any way affect the System and its operation.

Investment Office

This office is responsible for the investment activities of the System. In compliance with the investment policy established by the Board, PSERS' investment assets are allocated to numerous outside professional investment advisors and internal investment professionals.

Chief Counsel's Office

This office provides legal services through a team of professional personnel under the Governor's Office of General Counsel. The legal staff is responsible for representing the System in all administrative hearings and other litigation matters and providing counsel in a wide variety of matters including the interpretation of the Retirement Code, form and legality of all System contracts, corporate governance issues and the structure and implementation of the System's varied financial investments.

Internal Auditor's Office

This office performs systematic reviews of the various activities of PSERS, testing for compliance with applicable laws, policies and procedures. The Internal Auditor makes recommendations on the improvement of the System's internal control system.

Office of Financial Management

This office is directed by the Chief Financial Officer and has responsibility for planning, organizing and directing a complete accounting and financial reporting system in conformance with accounting principles generally accepted in the United States of America. Oversight is provided for new systems development and maintenance of existing systems, and ensuring appropriate accounting controls. The office is the liaison for other state and federal agencies, reporting units, financial consultants, actuaries, and investment advisors for all accounting, treasury operations, taxation, actuarial and budgetary matters. The office is organized into three divisions: General and Public Market Accounting Division, Annuitant Accounting Division, and Investment Accounting and Budget Division.

General and Public Markets Accounting Division

This division has the responsibility of recording all financial transactions for the pension and health care operations of the System. It maintains PSERS' General Ledger and prepares interim financial statements and is responsible for overseeing the preparation of PSERS' Comprehensive Annual Financial Report. It bills and collects contributions due to the Fund from its employers. It provides accounts receivable services to the System for member debts. It also interacts with the other units in the Office of Financial Management to assure that the basic financial statements of the System include all financial activity monitored and controlled by those areas. This division is responsible for directing and administering the Foreign Cash Overdraft and Foreign Tax Reclaim Collection programs as part of PSERS' investment activities. Working with the assistance of a third-party application service provider, it has the responsibility for monitoring the overall internal control structure for public market investments thereby assuring adequate custody of all Public Market investment assets.

Annuitant Accounting Division

This division is responsible for the mission-critical annuitant payroll and disbursement function. The division also has the responsibility of monitoring and recording post-employment healthcare transactions. It reconciles and monitors the financial activities of the third party administrator of the Health Options Program.

Investment Accounting and Budget Division

This division serves as intermediary with the custodian bank, the State Treasury Department, brokers, investment managers, the investment evaluator, and investment consultants. The division processes, audits and approves investment expenses, prepares monthly investment financial reports and processes all investment funding allocations. Working with the assistance of a third-party application service provider, it has the responsibility for monitoring the overall internal control structure for investments thereby assuring adequate custody of all non-Public Market investment assets.

Organizational Structure (continued)

The division is also responsible for directing and administering the Class Action Revenue Recovery program as part of PSERS' investment activities. It also supports PSERS' Investment Office and the Board in achieving investment objectives and monitoring compliance with investment policy. Additionally, the division is responsible for developing and monitoring the System's annual budget.

Deputy Executive Director

The Deputy Executive Director directly oversees the benefit programs for all active and retired members of the System, the development and implementation of the member and employer communications programs and the member counseling programs, and the maintenance of agency policies, procedures, and benefit related data. Additionally, this position oversees business and information technology strategic planning, policy development, and implementation.

Benefits Processed (Major Processes)		
Calendar Year	2013	2014
Initial Retirements (1-Step)	11,081	9,687
Initial Retirements (2-Step)	1,230	1,056
Final Retirements (2nd Step of 2-Step)	1,308	793
Purchases of Service and Corrections for Previously Unreported Service and/or Contributions not Withheld	18,951	19,515
Refunds	4,728	4,278
Deaths	6,035	8,147
Account Verification - non retirements	10,211	8,672
TOTAL	53,544	52,148
Percent of Retirement Paid as 1 Step	90%	90%

Bureau of Benefits Administration

The Bureau of Benefits Administration maintains account data, determines membership and benefits eligibility, and calculates benefits for Pennsylvania public school employees. This bureau provides these functions for all benefits provided by PSERS, except the PSERS Health Options and Premium Assistance Programs.

Benefits and Exceptions Division

This division is responsible for the timely and accurate processing of benefits, including all regular and disability retirements, post-retirement adjustments, death benefits, account valuations, domestic relations orders, and worker's compensation calculations.

Systems Support Division

The Systems Support Division provides key analytical services to the bureau and to other bureaus within the organization including specific services such as research, analysis, recommendations for action, and implementation support related to PSERS' information systems, data, or business or management processes.

Administrative Benefit Services Division

This division provides administrative support services to the bureau and manages the first level of the member appeals process. Additionally, the division provides quality assurance for data integrity and benefit calculations.

Member Account Division

The Member Account Division ensures that member account data is accurate and complete throughout the entire lifecycle of the member and serves the needs of our members, agency staff, employers, and PSERS actuaries. This critical data is used, among other things, to determine eligibility for, calculate, and pay benefits for PSERS members and as input in the determination of employer contribution rates and actuarial assumptions. As part of maintaining member accounts, in addition to maintaining and verifying the accuracy of account data, this division processes multiple service elections, purchases of service, account adjustments, and refunds of contributions and interest.

Bureau of Communications and Counseling

The bureau provides services to educate and inform annuitants, members, employers, staff and the public about the benefit related programs and services provided by PSERS, as well as the rights and duties of employers and members in relation to those benefits. Information communicated spans from very detailed and fact-specific explanations and instructions to more general explanations and educational materials.

Communications Services and Member Demographics Division

This division handles general inquiries primarily via telephone and other electronic mediums about the many benefits and processes of PSERS as well as specific inquiries related to a member's account and the functions related to the initial entry of a member into the retirement system. The division also provides for the production and publication of newsletters, handbooks, pamphlets, mass communications to the membership, and agency websites, and ensures that outgoing member and employer letters are written to ensure ease of comprehension and compliance with agency standards.

Organizational Structure (continued)

Other Member Services (Major)		
Calendar Year	2013	2014
Estimates	25,370	25,106
Phone Calls Answered	267,804	264,505
E-mails Received	16,164	14,328
E-mails Sent	12,298	12,786
General Information Sessions	201	198
General Information Attendees	13,665	10,849
Exit Counseling Sessions	983	919
Exit Counseling Attendees	8,962	7,694

Field Services Division A

This division is responsible for the majority of PSERS' regional offices defined as Division A to provide comprehensive services to both active and retired PSERS' members and their associated affiliates in PSERS' regional offices located throughout the Commonwealth of Pennsylvania. This includes the calculation of retirement benefit estimates, benefit counseling sessions with members to explain estimated retirement benefits, retirement options, death and survivor benefits, and other benefits issues, to assist members in understanding their retirement related decisions, and to respond to a variety of requests and inquiries regarding member accounts.

Employer Services and Field Services Division B

This division provides comprehensive services to employers, including technical training and workshops on PSERS' complex business rules and on the use and operation of the web-based reporting system used by employers to communicate member data to PSERS. The division is also responsible for PSERS' regional offices defined as Division B to provide comprehensive services to both active and retired PSERS' members and their associated affiliates in PSERS' regional offices located throughout the Commonwealth of Pennsylvania.

Information Technology Office

This office oversees the Bureau of Information Technology and the Business Architecture Center. It is responsible for strategic information technology planning and policy development, ensuring that information technology plans, projects and policies are aligned with, in support of, and prioritized according to agency needs and requirements as well as those Commonwealth needs and requirements that are consistent with agency needs, and for communicating such to the agency's Information Technology staff. Large information technology contracts and projects are managed by this office. This bureau is responsible for understanding, analyzing, documenting, and improving PSERS' processes, information systems, and the relationships among these components so that PSERS is able to: conduct its business consistently and according to established rules; understand each component, its relationship to each of the other components and to PSERS' mission, vision, values and goals; fully, yet quickly analyze and understand the impact of potential change to one or more of these components on the others; more effectively identify inefficient, duplicate, or suspect processes, technologies; account for its processes, information systems and technologies.

Business Architecture Center

This center serves as the repository for PSERS' business knowledge and makes that knowledge available and understandable to agency processing and technology staff. The center receives and responds to data queries from agency staff and investigates system, data, or process problems. This center includes staff who collect, analyze, and document PSERS' processes, information systems and data, and perform detailed impact analysis as and when change is proposed. Additionally, staff in this unit coordinate, lead, and track projects and confirm that changes have been applied correctly. They look for opportunities for improvement, lead the development of business requirements, and serve as liaisons between PSERS' end-users and Information Technology staff.

Bureau of Information Technology

This bureau is responsible for planning, coordinating, administering, and implementing information technology resources in accordance with the agency's strategic plans, goals, objectives, and priorities as communicated by PSERS' Chief Information Officer, and for providing operational support for those technologies and initiatives.

Infrastructure and Technical Services Division

This division is responsible for administering those information technology resources that collectively provide the fundamental hardware, software, security, network components and services required to support PSERS' various applications.

Business Applications Division

This division provides consultative, technical, and operational support in the planning, design, specification, configuration, development, implementation, interfacing, operation, support, and troubleshooting of PSERS' business applications.

Organizational Structure (continued)

Assistant Executive Director

This position reports to the Executive Director and may provide assistance to the Executive Director on agency-wide projects. The position administers the Health Options and Premium Assistance Programs in addition to the facilities, human resources, and procurement activities necessary to support, secure and optimize agency operations. Organizational units overseen by the Assistant Executive Director include the Bureau of Administration, the Human Resources Office, and the Health Insurance Office.

Bureau of Administration

This bureau provides facilities, purchasing and contracting, policies and procedures, business continuity, records management, automotive, mail, imaging, and other administrative services necessary to support agency functions.

Purchasing and Contracting Division

This division procures materials, supplies, and services needed to support organizational goals and develops, monitors, processes and evaluates contract usage in the agency.

Administrative Services Division

This division manages building and grounds for the agency both at headquarters and at the regional locations, provides mail, imaging services, asset management and other administrative services to the agency.

Security, Business Continuity, and Records Management Division

This division develops and implements those policies, programs and procedures necessary to ensure that PSERS' technology, and capital resources are secure and to ensure that PSERS is prepared to quickly recover and continue critical operations in the event of a disaster. The division also maintains office safety and health programs and is responsible for managing PSERS' electronic data records, imaged records, paper records and film/fiche records.

Human Resources Office

This office is responsible for supporting management and staff to facilitate the accomplishment of the agency's mission. It administers all human resources programs and ensures compliance with labor law and Commonwealth regulations. Programs include position classification, labor relations, recruitment and placement, employee benefits, employee compensation and pay, training and staff development, time and attendance, performance management, organizational development and support, employee transactions, Equal Employment Opportunities and other miscellaneous programs.

Health Insurance Office

This office is responsible for all aspects of the PSERS' Health Options Program (HOP) and administering the PSERS annuitant health insurance premium assistance benefits. HOP is a voluntary statewide plan that provides group health insurance coverage for school retirees, their spouses, and eligible dependents.

PSERS Regional Offices

There are eight PSERS Regional Offices strategically located throughout the Commonwealth. The offices provide services to both active and retired PSERS members and 789 employers. Among these services are regularly scheduled retirement counseling meetings and other informational presentations on various topics relating to retirement benefits and programs.

PSERS REGIONAL OFFICES

Public School Employees' Retirement System of Pennsylvania

PSERS FIELD SERVICES DIVISION

Serving You in the 21st Century

NORTHWEST
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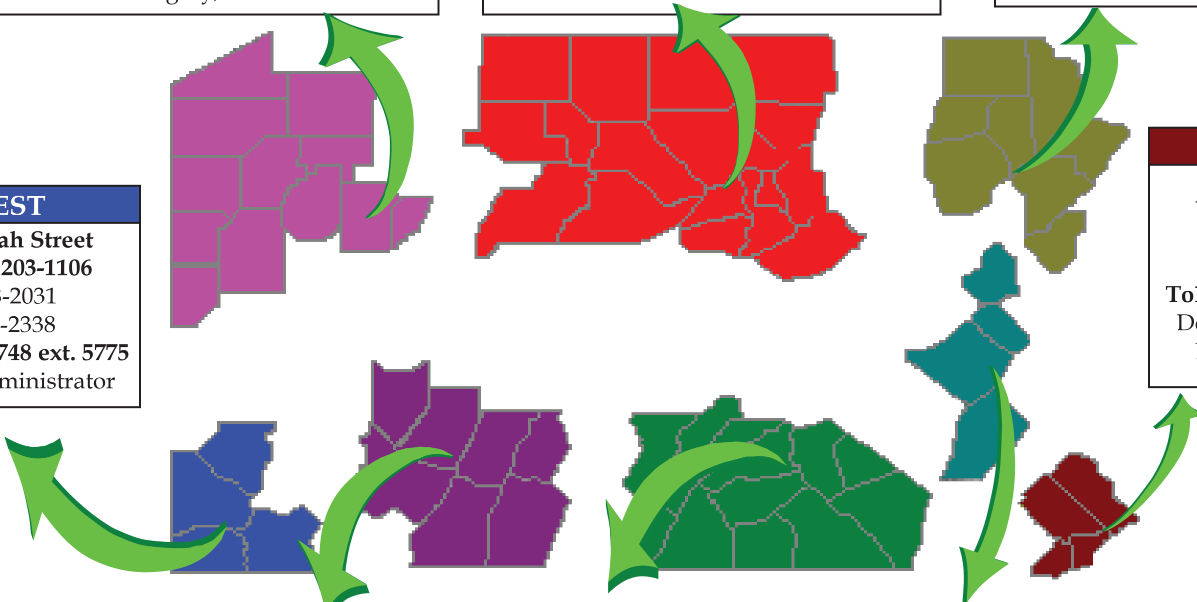

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Lisa A. York, Administrator

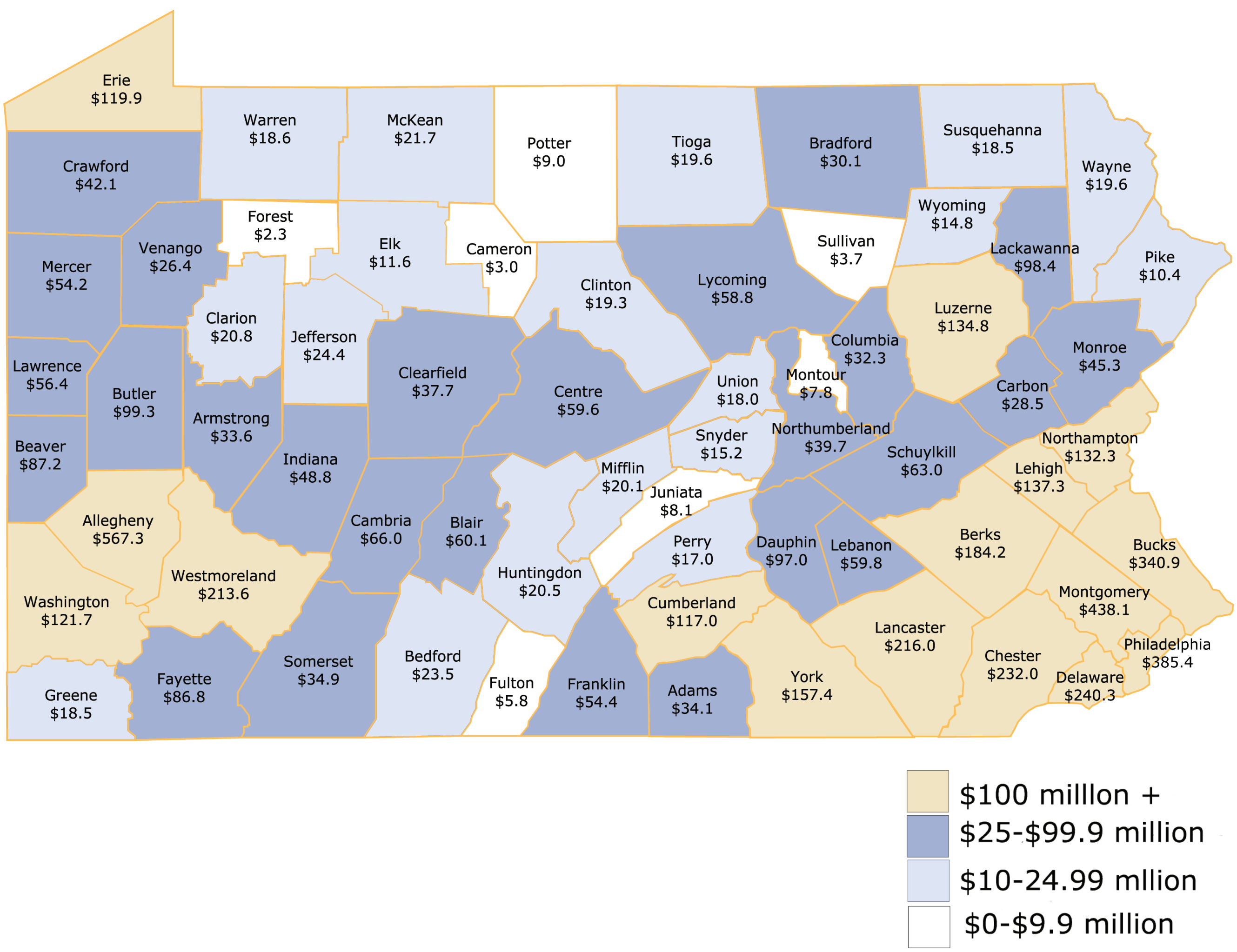
Member Demographics and Financial Information

Economic Impact of Pension Benefits on Pennsylvania
In calendar year 2014, PSERS pension disbursements to retirees totaled approximately $6.1 billion. Of this amount, approximately 90%, or $5.5 billion, went directly into state and local economies. Pension benefits received by retirees are re-invested in local communities, and support thousands of jobs.

The map below shows PSERS pension benefit disbursements by county for calendar year 2014.

Top 10 Counties Based on amount of Disbursements to Retirees from PSERS (Millions)	
Allegheny	$567.3
Montgomery	$438.1
Philadelphia	$385.4
Bucks	$340.9
Delaware	$240.3
Chester	$232.0
Lancaster	$216.0
Westmoreland	$213.6
Berks	$184.2
York	$157.4

Public School Employees' Retirement System Total Pension Benefit Disbursement by County for CY 2014 (millions)



Member Demographics and Financial Information (continued)

Members by Type						
Fiscal Year ended June 30	**Active Members**	**Inactive Members**	**Annuitants, Beneficiaries, and Survivor Annuitants**	**Total Active/Retired Members**	**Ratio of Active/ Retired**	**Total Inactive, Active & Survivor Annuitants**
2014	263,312	132,564	213,900	477,212	1.23 to 1	609,776
2013	267,428	128,650	209,204	476,632	1.28	605,282
2012	273,504	122,286	202,015	475,519	1.35	597,805
2011	279,152	115,102	194,622	473,774	1.43	588,846
2010	282,041	111,931	184,934	466,975	1.53	578,906
2009	279,701	103,805	177,963	457,664	1.57	561,469
2008	272,690	100,803	173,540	446,230	1.57	547,033
2007	264,023	109,186	168,026	432,049	1.57	541,235
2006	263,350	94,071	161,813	425,163	1.62	519,234
2005	255,465	58,720	156,519	411,984	1.63	470,704
Average ratio of annuitants to active members (Public Funds)					1.55*	

*Based on the January 2015 Public Fund Survey prepared by the National Association of State Retirement Administrators (NASRA).

Profile of PSERS' Annuitants, Beneficiaries, and Survivor Annuitants				
Type of Member	**Number of Members**		**Average Annual Benefit**	
	6/30/2013	**6/30/2014**	**6/30/2013**	**6/30/2014**
Normal/Early Retirees	189,170	194,886	$25,746	$25,889
Survivor Annuitants	11,469	10,144	10,394	12,625
Disability Retirees	8,565	8,870	18,384	18,723
Total	209,204	213,900	$24,603	$24,962

Age and Service Profile of All Active Members		
	June 30, 2013	**June 30, 2014**
Average Age	44.8 years	44.8 years
Average Years of PSERS Service	10.8 years	11.0 years
Average Annual Compensation	$47,030	$47,931

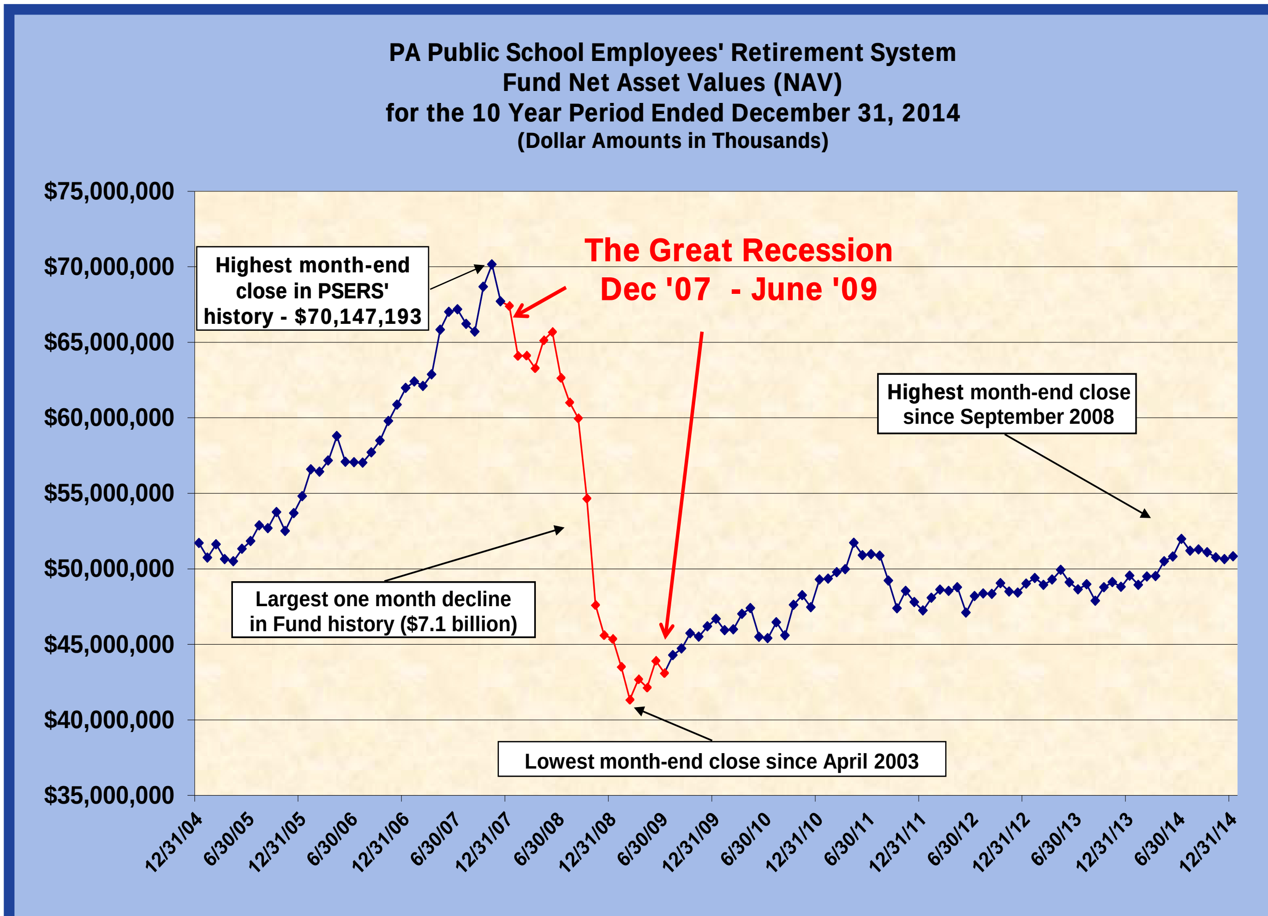
Class T-E Members		
	June 30, 2013	**June 30, 2014**
Number of Members	22,405	32,638
Average Age	35.9 years	36.6 years
Average Years of PSERS Service	0.7 years	1.0 years
Average Annual Compensation	$22,573	$24,016

Class T-F Members		
	June 30, 2013	**June 30, 2014**
Number of Members	3,496	5,391
Average Age	35.3 years	35.6 years
Average Years of PSERS Service	0.9 years	1.3 years
Average Annual Compensation	$30,532	$33,035

Member Demographics and Financial Information (continued)

PSERS Pension Plan Changes in Fiduciary Net Position
10 Year Cumulative Summary-Calendar Year
(Dollar Amounts in Millions)

		Cumulative 10 Year Total
		January 1, 2005 - December 31, 2014
Balance of Net Position (01/01/05)		$ 51,993
Member Contributions	$ 9,257	
Employer Contributions	9,454	
Net Investment Income	31,359	
Total Deductions - Benefits & Expenses	(50,666)	
Net Decrease		$ (596)
Balance of Net Position (12/31/14)		$ 51,397



The above chart illustrates the changes to PSERS' Net Asset Values for the past ten years. Since the Great Recession recent asset growth has been slow even as the employer contributions have risen, in accordance with Act 120, due to the benefit payments that have also increased.

Member Demographics and Financial Information (continued)

PSERS Pension Plan Changes in Fiduciary Net Position 10 Year Cumulative Summary-Fiscal Year (Dollar Amounts in Millions)		
	Cumulative 10 Year Total July 1, 2004 - June 30, 2014	
Balance of Net Position (07/01/04)		**$ 48,340**
Member Contributions	$ 9,168	
Employer Contributions	8,454	
Net Investment Income	36,399	
Total Deductions - Benefits & Expenses	(49,381)	
Net Increase		**$ 4,640**
Balance of Net Position (6/30/14)		**$ 52,980**

Cash Flow Fiscal Years Ended in June 30 (Dollar Amounts in Millions)		- - - Projected - - -	
	2014	**2015**	**2016**
Member Contributions	$ 967	$ 979	$ 1,006
Employer Contributions	1,992	2,792	3,462
Total Contributions	**$ 2,959**	**$ 3,771**	**$ 4,468**
Less:			
Pension Benefits	6,029	6,451	6,720
Negative Cash Flow	**$ -3,070**	**$ -2,680**	**$ -2,252**
Beginning of Year Total Assets	**$ 49,016**	**$ 52,992**	**$ 54,220**
Negative Cash Flow (NCF) as a % of Total Assets	**-6.3%**	**-5.1%**	**-4.2%**
Average NCF as a % of Total Assets (Public Funds)	**-2.7%***		

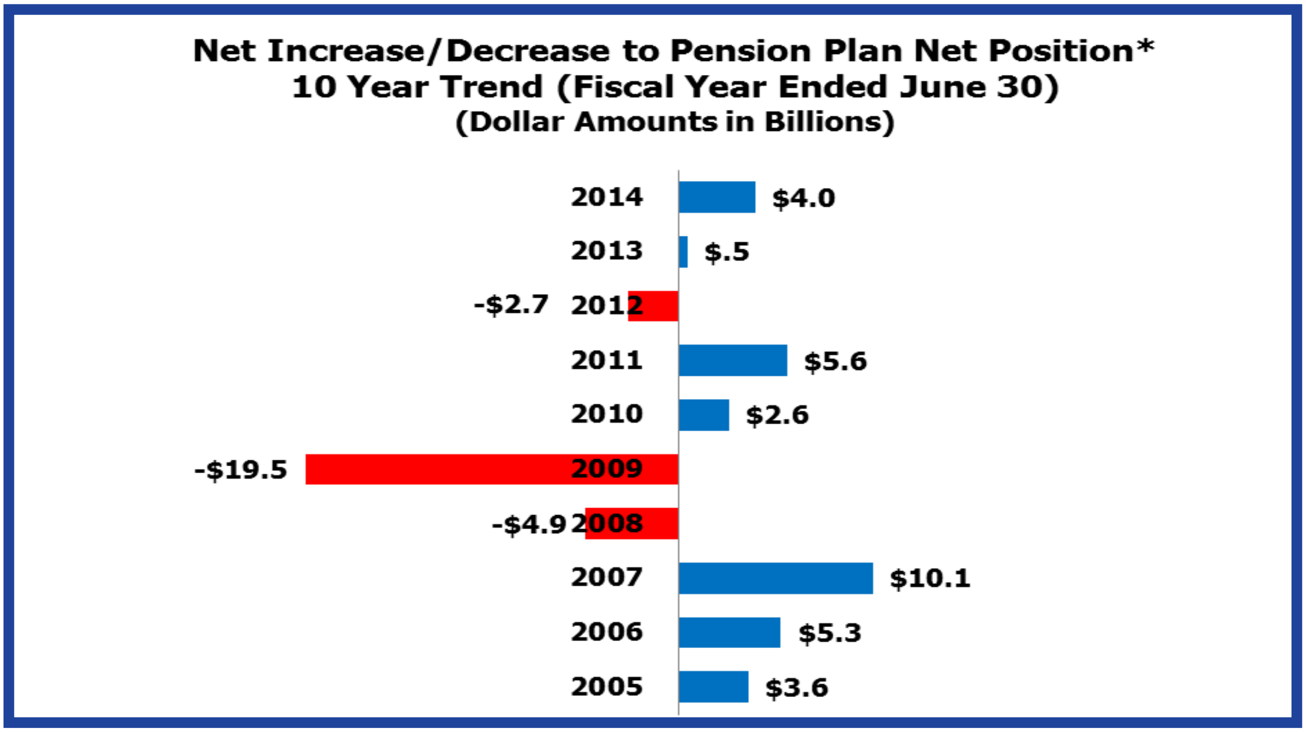
*Based on the January 2015 Public Fund Survey prepared by NASRA.

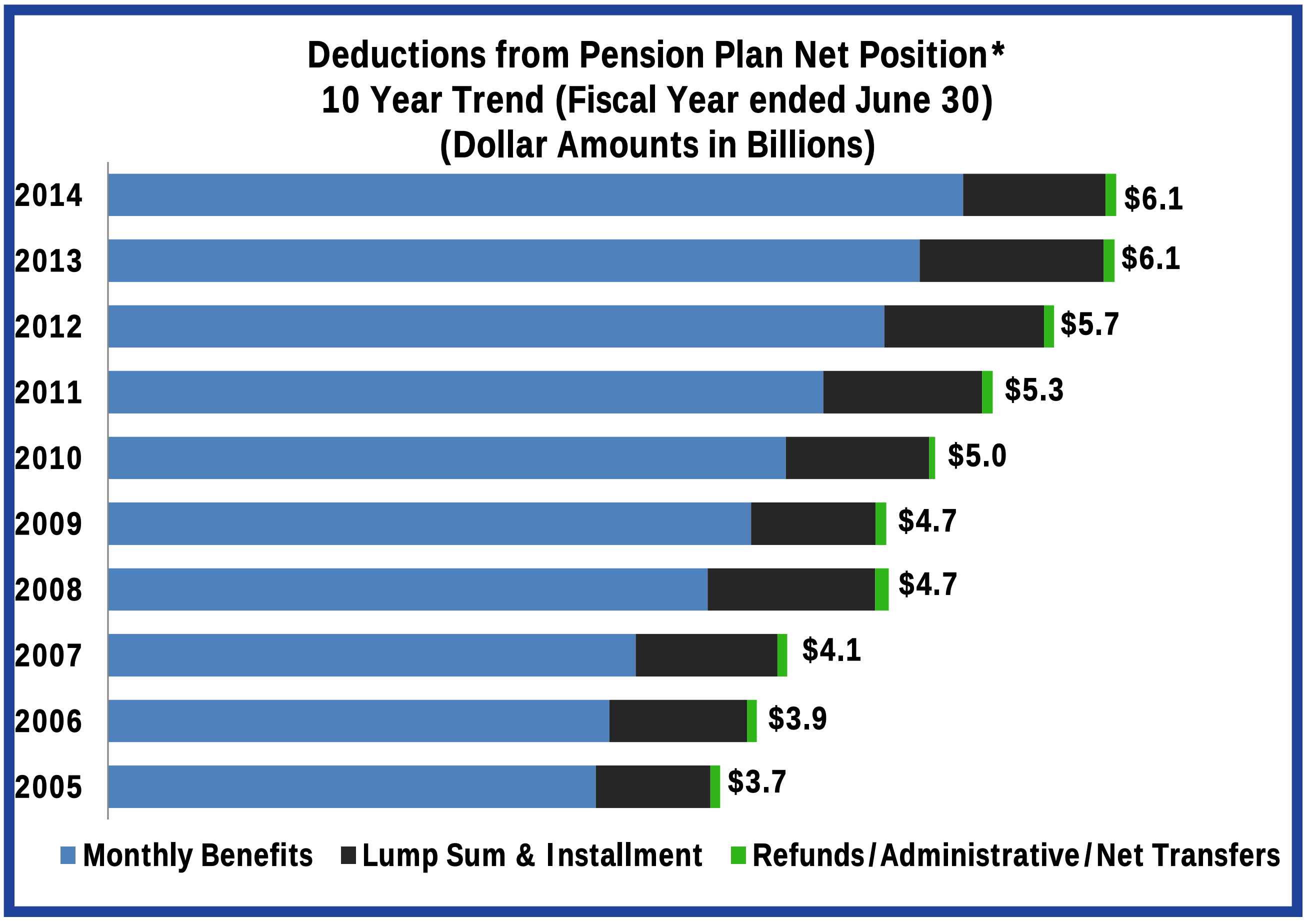
Negative Cash Flow (NCF)

Using data from the table at the top of the page, the last 10 years of contributions and benefit payments resulted in a NCF of -$31.8 billion during that time period. For the fiscal year ended June 2014, PSERS' NCF percentage is -6.3% which is more than twice the public fund average. PSERS' projected NCF percentage of -4.2% will remain above the public fund average through FY2015/16 because, in accordance with Act 120, the employer contributions will remain below the actuary's recommended level, and PSERS' funded ratio is below the public fund average.

As a result of the large negative cash flow, PSERS has to sell a portion of its investments each year to fund benefit payments. Consequently, even during years when PSERS meets its investment return assumption, the Fund's assets will grow very slowly until employer contribution rates increase to the level recommended by PSERS' actuary. In FY2017/18 contributions will be sufficient to begin to pay down the unfunded liability.

Member Demographics and Financial Information (continued)





*Does not include PSERS Postemployment Healthcare Plan Net Assets.

Statement of Fiduciary Net Position
December 31, 2014
(Dollar Amounts in Thousands)

	2014			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Assets:				
Receivables:				
Members	$ 294,319	$ 3,856	$ 36	$ 298,211
Employers	484,121	28,464	-	512,585
Investment income	140,228	31	16	140,275
Investment proceeds	531,133	-	-	531,133
CMS Part D and prescriptions	-	-	42,396	42,396
Interfund	1,634	-	-	1,634
Miscellaneous	409	1,192	-	1,601
Total Receivables	1,451,844	33,543	42,448	1,527,835
Investments, at fair value:				
Short-term	3,240,065	81,990	197,709	3,519,764
Fixed income	5,563,568	-	-	5,563,568
Common and preferred stock	10,500,490	-	-	10,500,490
Collective trust funds	12,559,597	-	-	12,559,597
Real estate	6,643,591	-	-	6,643,591
Alternative investments	11,975,763	-	-	11,975,763
Total Investments	50,483,074	81,990	197,709	50,762,773
Securities lending collateral pool	594,501	-	-	594,501
Capital assets (net of accumulated depreciation $25,116)	22,815	-	-	22,815
Total Assets	52,552,234	115,533	240,157	52,907,924
Liabilities:				
Accounts payable and accrued expenses	101,736	305	1,763	103,804
Benefits payable	193,634	-	22,244	215,878
Participant premium advances	-	-	23,252	23,252
Investment purchases and other liabilities	265,373	-	-	265,373
Obligations under securities lending	594,501	-	-	594,501
Interfund payable	-	1,634	-	1,634
Total Liabilities	1,155,244	1,939	47,259	1,204,442
Net position restricted for pension and postemployment healthcare benefits	$ 51,396,990	$ 113,594	$ 192,898	$ 51,703,482

Statement of Changes in Fiduciary Net Position
Six Months Ended December 31, 2014
(Dollar Amounts in Thousands)

	2014			
		Postemployment Healthcare		
	Pension	Premium Assistance	Health Options Program	Totals
Additions:				
Contributions:				
Members	$ 457,335	$ -	$ -	$ 457,335
Employers	1,201,070	55,457	-	1,256,527
Total contributions	1,658,405	55,457	-	1,713,862
Participant premiums	-	-	136,439	136,439
Centers for Medicare & Medicaid Services premiums	-	-	33,214	33,214
Investment income:				
From investing activities:				
Net appreciation (depreciation) in fair value of investments	(687,676)	(99)	-	(687,775)
Short-term	5,010	199	91	5,300
Fixed income	88,265	-	-	88,265
Common and preferred stock	113,620	-	-	113,620
Collective trust funds	650	-	-	650
Real estate	184,434	-	-	184,434
Alternative investments	257,573	-	-	257,573
Total investment activity income (loss)	(38,124)	100	91	(37,933)
Investment expenses	(223,835)	-	-	(223,835)
Net income (loss) from investing activities	(261,959)	100	91	(261,768)
From securities lending activities:				
Securities lending income	5,608	-	-	5,608
Securities lending expense	(550)	-	-	(550)
Net income from securities lending activities	5,058	-	-	5,058
Total net investment income (loss)	(256,901)	100	91	(256,710)
Total Additions	1,401,504	55,557	169,744	1,626,805
Deductions:				
Benefits	2,954,456	52,996	132,869	3,140,321
Refunds of contributions	9,668	-	-	9,668
Net transfer to State Employees' Retirement System	215	-	-	215
Administrative expenses	20,290	1,027	13,726	35,043
Total Deductions	2,984,629	54,023	146,595	3,185,247
Net increase (decrease)	(1,583,125)	1,534	23,149	(1,558,442)
Net position restricted for pension and postemployment healthcare benefits:				
Balance, beginning of year	52,980,115	112,060	169,749	53,261,924
Balance, end of period	$ 51,396,990	$ 113,594	$ 192,898	$ 51,703,482

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The Actuarial Process and Pension Plan Funding

PSERS is a defined benefit plan, meaning benefits are based on members' service and salary history. The following information highlights the actuarial process and funding for PSERS.

Actuarial Process

The actuarial process presumes that there will be a systematic flow of contributions at a specified level to pay for plan benefits and that the flow of contributions, together with investment earnings, will be sufficient to meet all benefit and expense requirements of the plan. Actuarial cost methods for funding PSERS pension plan are defined in the Public School Employees' Retirement Code. The actuary for the pension plan reviews economic and demographic experience annually and over five-year periods. The actuary's periodic valuations test the validity of the underlying actuarial assumptions versus the actual experience of the plan. That experience is also used as a basis for formulating actuarial assumptions about what will occur in the future with respect to salary growth, investment returns, and demographic factors such as rates of retirement and death.

Effective with the June 30, 2011 actuarial valuation, PSERS adopted several new demographic and economic assumptions as a result of the Five-year Experience Study completed by PSERS' actuary. PSERS' investment rate of return assumption was changed from 8.00% to 7.50%, the Salary Growth Assumption was changed from 6.00% to 5.50%, and new mortality tables were adopted.

Funding

The plan is funded through three sources: (1) employer contributions; (2) member contributions; and, (3) investment earnings. As depicted in the chart at the bottom of the page, for the twenty-year period ended June 30, 2014 investment earnings provided 71% of PSERS' funding followed by 15% from members. Employers contributed 14%, the smallest of the three sources.

Employer Contributions

The Retirement Code vests PSERS' Board with the authority to establish the employer contribution rate (ECR). The Board, in consultation with the actuary, establishes the employer contribution rate annually, as part of the annual actuarial valuation. The employer contribution rate, which is expressed as a percentage of payroll, is composed of two items: (1) the pension contribution; and, (2) the contribution for health care premium assistance.

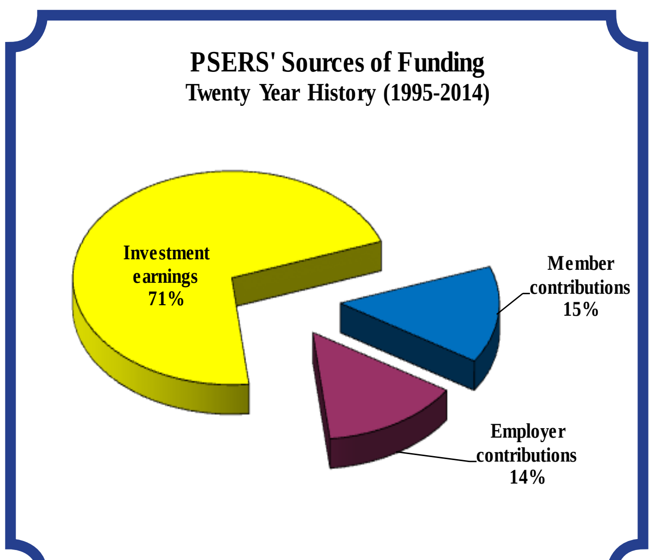
The total employer contribution rate for the fiscal year ended June 30, 2014 was 16.93%, including 0.93% for healthcare premium assistance. The total employer contribution rate for the fiscal year ending June 30, 2015 is 21.4%. This rate consists of a 20.5% pension rate (FY2013/14 pension rate of 16.0% plus the Act 120 4.50% collar) plus the healthcare premium assistance contribution of 0.90%. The FY2015/16 employer contribution rate is 25.84%. This rate consists of a 25.0% pension rate (FY2014/15 pension rate of 20.5% plus the Act 120 4.50% collar) plus the healthcare premium assistance contribution of 0.84%. The Board of Trustees certified this rate, which was calculated in accordance with the provisions of Act 120 of 2010, at their December 2014 meeting. Without the Act 120 collar the total employer contribution rate would be 28.66% in FY2015/16.

For the fiscal year ended June 30, 2014, PSERS' employer contributions totaled $2.110 billion, which includes $118 million for healthcare premium assistance. For the fiscal year ending June 30, 2015 the estimate for employer contributions is $2.885 billion, reflective of the 21.4% contribution rate. The contribution rate for the fiscal year ending June 30, 2016 is 25.84% resulting in an employer contribution estimate of $3.456 billion.

Member Contributions

Members of the Public School Employees' Retirement System who, prior to Act 9 of 2001, contributed to the Retirement Fund at the rate of 6.25% of their gross compensation, began contributing 7.50% in January of 2002, if they elected the higher retirement benefits. Members who contributed at the rate of 5.25% began contributing 6.50% if they elected the higher retirement benefits under Act 9 0f 2001. The average contribution rate payable by the members for the current year (FY2014/15) is 7.46%.

In accordance with Act 120 of 2010, any employee who becomes a member after June 30, 2011 is a Class T-E member or, alternatively, can elect to become a Class T-F member. The base contribution rate for Class T-E members is 7.50% of compensation. The base contribution rate for Class T-F members is 10.30% of compensation.



The Actuarial Process and Pension Plan Funding (continued)

Class T-E and Class T-F members are subject to a "shared risk" employee contribution rate. The member contribution rate will stay within the specified range alloted for Class T-E or Class T-F, but could increase or decrease every three years starting July 1, 2015 depending on investment performance. Members now share a portion of the investment risk of the Fund giving PSERS a defined contribution element. As a result of the Fund's 8.66% three year return through June 30, 2014 exceeding the investment performance hurdle mandated by Act 120, the member rate will not change. The next investment performance measurement period for Class T-E and T-F members will end on June 30, 2017.

PSERS members contributed $967 million for pension contributions for FY2014. Total member contributions are estimated to be $979 million for the fiscal year ending June 30, 2015 and $1.006 billion for the fiscal year ending June 30, 2016.

Investment Returns

The investment rates of return (net of fees) for the fiscal years ended June 30, 2014 and June 30, 2013 were 14.91% and 7.96%, respectively. The annualized rates of investment return for the three, five and ten-year periods ended June 30, 2014 were 8.66%, 12.09% and 7.28% respectively. The investment rates of return for the one, three, five and ten-year periods ended December 31, 2014 were 8.83%, 9.61%, 9.43% and 6.35%, respectively. Over the past 25 years ended December 31, 2014, the Fund earned an estimated annualized rate of return of 8.46% which exceeded the Fund's long term investment rate of return assumption during that time period.

PSERS' investments continue to positively impact the funding situation at the System. Due to PSERS' strong investment performance and lower employer payroll, over the past fiscal year a number of pension funding projections have improved, including:

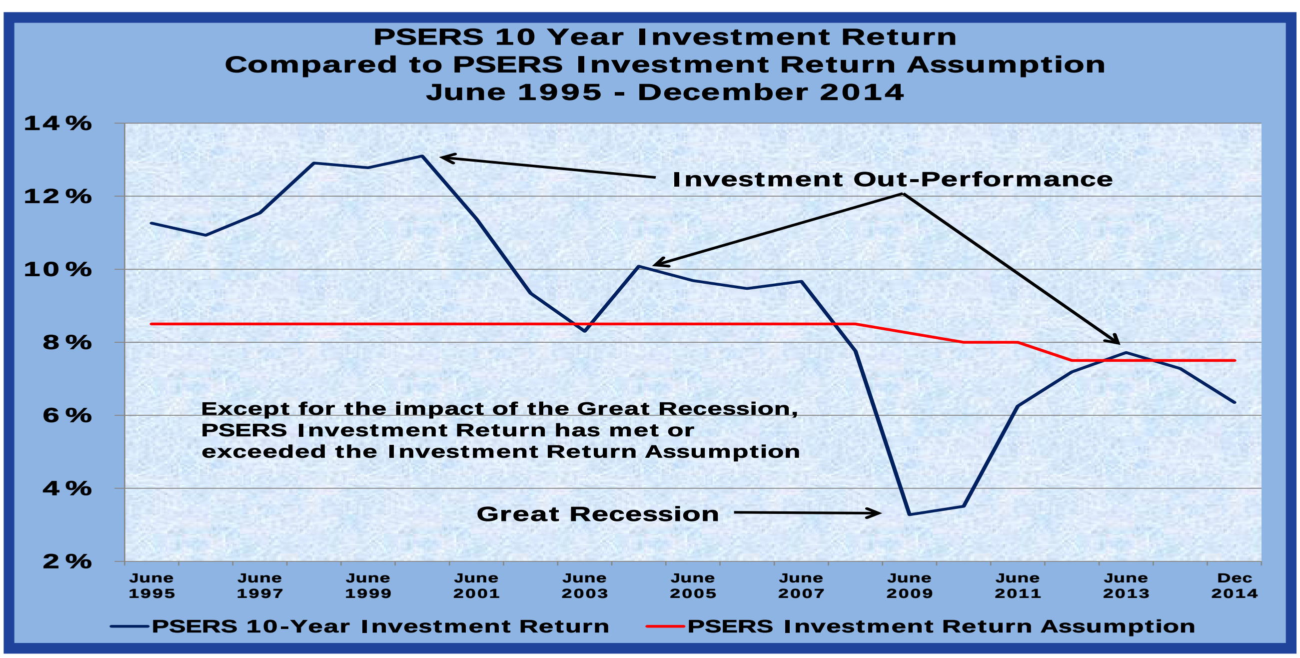
- Total employer contribution dollars through FY2047 are projected to decrease by $13.7 billion.

- The pension debt or the unfunded accrued liability (UAL) at June 30, 2014 is $500 million less than projected one year ago.

- The peak UAL dollar amount projected for FY2018 is $2 billion less than what was projected last fiscal year.

- The annual employer cost for benefits for current service (the employer normal cost) continues to decrease. It decreased from 8.66% in FY 2012/13 to 8.38% in FY2015/16 as more new members join the system under the reduced benefit structure of Act 120 of 2010.

PSERS' ten-year return, as shown in the chart at the bottom of the page, has exceeded the actuarial investment rate of return for 13 of the last 20 years. Throughout much of the 1990s and 2000s PSERS' investment performance exceeded its investment rate of return assumption. This outstanding investment performance resulted in declining employer contribution rates and/or contribution rates lower than the annual normal cost of benefits for most of those two decades. Due to negative returns during the Great Recession, which resulted in the largest decrease in stock market performance since the Great Depression, PSERS recent ten-year return has been below the assumed rate of return.



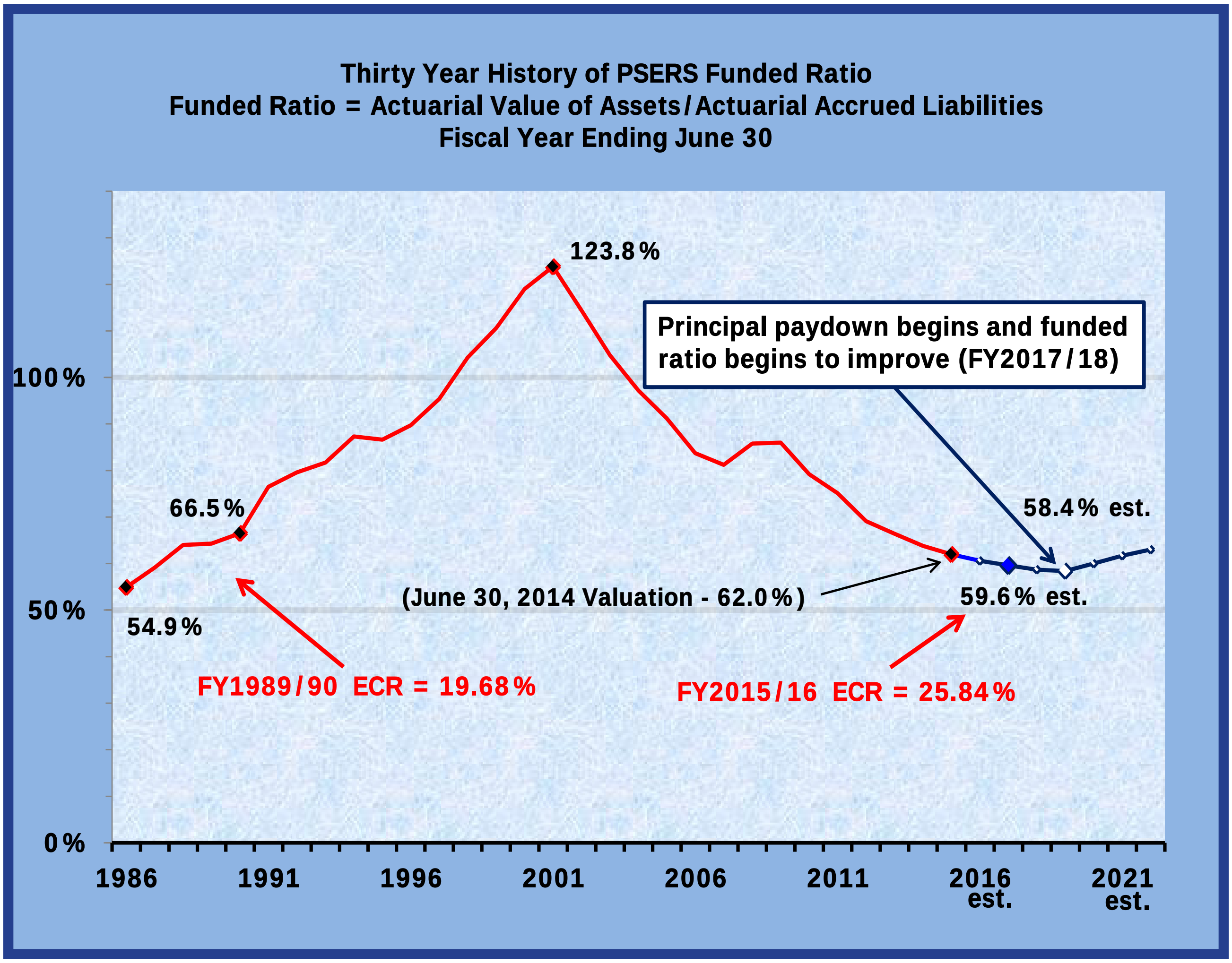
The Actuarial Process and Pension Plan Funding (continued)

Funded Status

PSERS' funded status is measured by comparing the actuarial value of assets with the accrued liability. The accrued liability is the present value of benefits accumulated to date for both active and retired members.

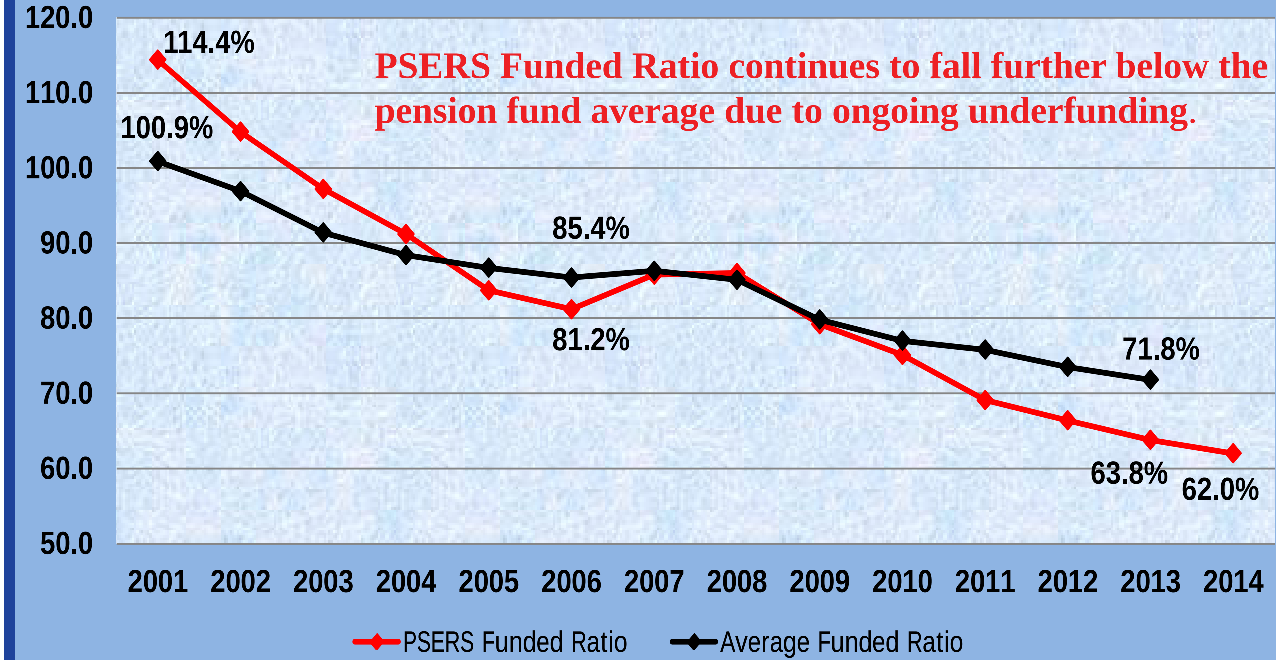
Key Facts

- Funded Status: 62.0% as of June 30, 2014
- Funded Status: 63.8% as of June 30, 2013
- The decrease in FY2014 is primarily due to the actuarial value of assets loss that occurred during the year as a result of the 10 year asset smoothing used for actuarial valuation purposes and the continued underfunding of PSERS by its employers. As a result of Act 120, employers underfunded PSERS by $2.0 billion in FY2014.
- The decrease in the funded status since 2000 is the result of several factors including: the unfavorable investment markets from FY2001 to FY2003 and FY2008 to FY2009; funding changes enacted in Act 38 of 2002 and Act 40 of 2003 which resulted in employers underfunding PSERS; the adoption of new demographic and economics assumptions in FY2008, FY2009 and FY2011; funding collars in Act 120 of 2010 which have continued the employer underfunding of the system; and, actuarial liability losses.
- A thirty-year history and seven-year projection of PSERS' funded status is shown below.



The Actuarial Process and Pension Plan Funding
(continued)

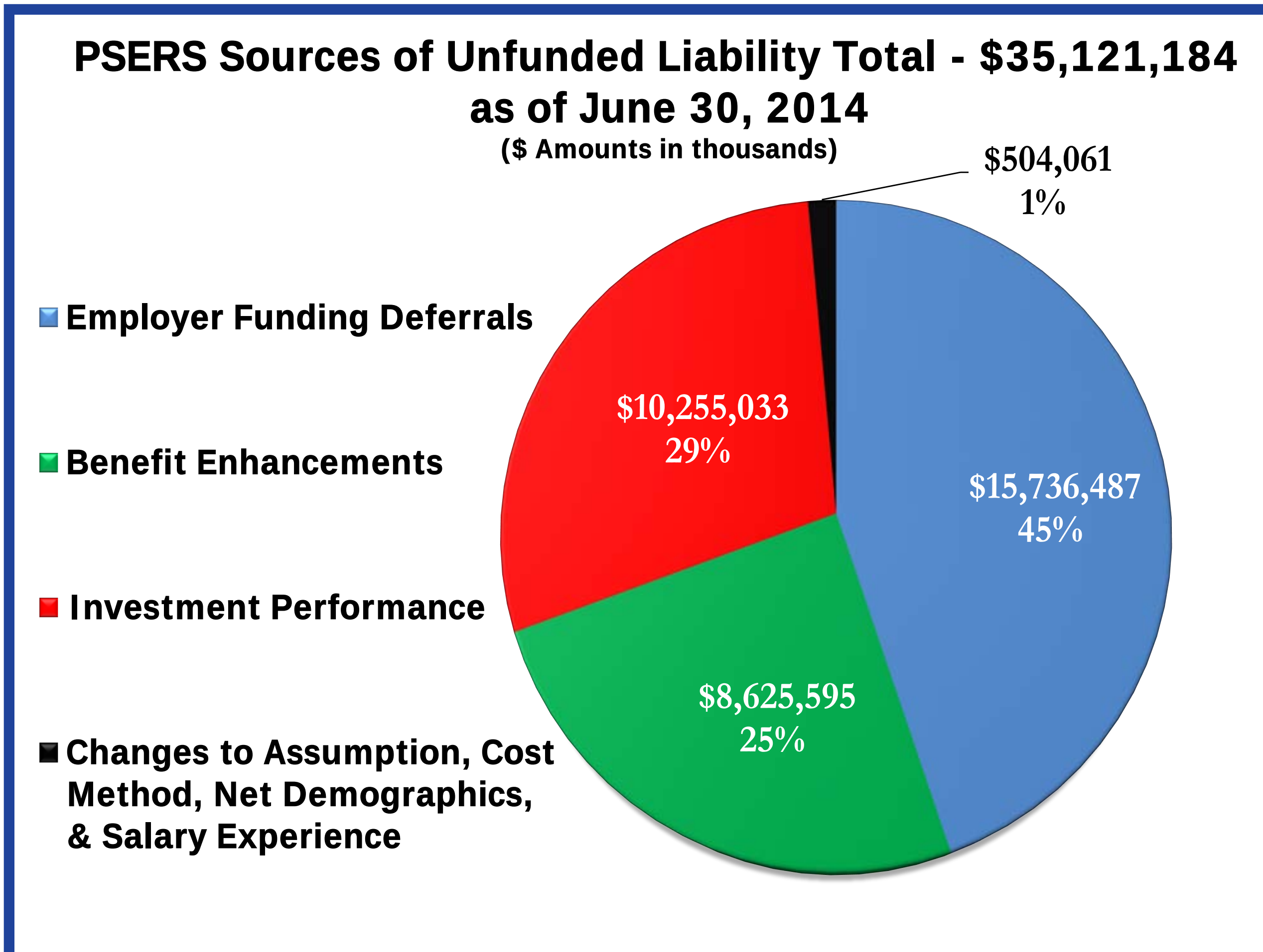
Public Fund Survey's Average Funded Ratio vs. PSERS Funded Ratio
Fiscal Year Ending June 30



A comparison of PSERS funded ratio to the public fund average funded ratio based on the January 2015 Public Fund Survey prepared by the National Association of State Retirement Administrators (NASRA) is charted above. A lower than average funded ratio is an important factor because it signifies a smaller than average asset base. A smaller asset base means a greater percentage of the investment returns are being used to pay benefits, and results in a very slow growth of assets.

Besides market performance, other factors that affect a plan's funding level include contributions made relative to those that are required; changes in benefit levels; changes in actuarial assumptions, and rates of employee salary growth (*Public Fund Survey,* January 2015).

The Actual Process and Pension Plan Funding
(continued)



Sources of Unfunded Liability

The System's total funded ratio (for Pensions and Health Insurance combined) is 62.0% as of June 30, 2014. This funded ratio is based on an actuarial value of assets of $57.34 billion and an accrued liability of $92.46 billion which equates to a $35.12 billion unfunded liability. The pie-chart above depicts the sources of the unfunded liability. The largest sources of unfunded liability in order of magnitude are employer funding deferrals (45%), investment performance (29%), and benefit enhancements (25%), which include Act 9, cost of living increases and early retirement incentives. As a result of the Act 120 contribution rate collars, employer funding deferrals will continue to increase the unfunded liability for several years.

For many years PSERS' outstanding investment performance, which exceeded the investment return assumption, compensated for unfunded benefit enhancements and employer funding deferrals. The Great Recession eliminated the previous investment out-performance and reduced PSERS' long-term investment performance which, as of December 31, 2014, is now below its return assumption of 7.50%. Without the investment out-performance to compensate, the employer funding deferrals and benefit enhancements have significantly increased PSERS' unfunded liability. Seventy percent of PSERS' June 30, 2014 unfunded liability is due to employer funding deferrals and benefit enhancements.

The Actuarial Process and Pension Plan Funding
(continued)

GASB Pension Accounting and Financial Reporting Project (Pension Project)

In June 2012, the Governmental Accounting Standards Board (GASB) approved a pair of related Statements that reflect substantial changes to the accounting and financial reporting of pensions by state and local governments and pension plans. Statement No. 67, *Financial Reporting for Pension Plans*, addresses financial reporting for state and local government pension plans. Statement No. 68, *Accounting and Financial Reporting for Pensions,* establishes new accounting and financial reporting requirements for governments that provide their employees with pensions.

Statement No. 67 replaced the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* for most public employee pension plans. Statement No. 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, for most government employers. The new statements also replace the requirements of Statement No. 50, *Pension Disclosures*, for those governments and pension plans.

Statement No. 67 provides public employee pension plans such as PSERS guidance for financial reporting. Statement No. 67 significantly changed related financial reporting through note disclosures and new required supplementary information (RSI) schedules. These changes are necessary for government employers to comply with Statement No. 68.

PSERS adopted Statement No. 67 for the fiscal year ended June 30, 2014. An analysis of the major differences between Statement No. 67 and Statement No. 25 can be found in the Management's Discussion and Analysis, notes to the financial statements, and RSI found in the Financial Section of PSERS' Comprehensive Annual Financial Report. PSERS will also post three schedules as recommended by the American Institute of Certified Public Accountants (AICPA) to the Employer page of PSERS' website. These three schedules, the Schedule of Employer Allocations, the Schedule of Pension Amounts by Employer, and Amortization Schedules of Deferred Inflows and Outflows will further assist employers in implementing Statement No. 68.

Beginning in 2013, PSERS began an outreach effort to its employers. This mainly consisted of speaking at various conferences held by the Pennsylvania Association of School Business Officials (PASBO), Pennsylvania School Boards Association (PSBA), and the Pennsylvania Institute of Certified Public Accountants (PICPA). Additionally, PSERS has published articles in its Employer Bulletin, beginning with Volume 4 of 2014. These articles will continue with each Employer Bulletin issue through July of 2015.

Employer Contribution Rate

PSERS undergoes an annual independent actuarial valuation to calculate the actuarial assets and liabilities of the pension fund. Based on the actuarial valuation process, the actuary develops the recommended Employer Contribution Rate (ECR) that determines the employer contributions to the pension plan and healthcare premium assistance. The valuation process also measures the progress of the pension system towards funding pensions for its active and retired members.

Employer Contribution Rate Statistics

• Highest historical ECR (FY2014/15)	21.40%
• Lowest historical ECR (FY2001/02)	1.09%
• Ten yr. avg. ECR (2005/06 to 2014/15)	9.28%
• Twenty yr. avg. ECR (1995/96 to 2014/15)	7.34%
• Thirty yr. avg. ECR (1985/86 to 2014/15)	10.59%
• Adopted ECR (FY2015/16)	25.84%

Act 120 of 2010

Progress on Funding Issue

PSERS is in the 4th year of a multi-year phase in of Act 120 of 2010. Act 120 provided historic pension reform and made dramatic progress toward addressing funding issues at PSERS. The legislation included actuarial and funding changes to PSERS and benefit reductions for individuals who became new members of PSERS on or after July 1, 2011. Members hired since the passage of Act 120 now total over 38,000 and account for 14% of the total active membership.

Impact of Benefit Cuts for New Members on or after July 1, 2011

For school employees who became new members of PSERS on or after July 1, 2011, there are two new classes; Class T-E and T-F.

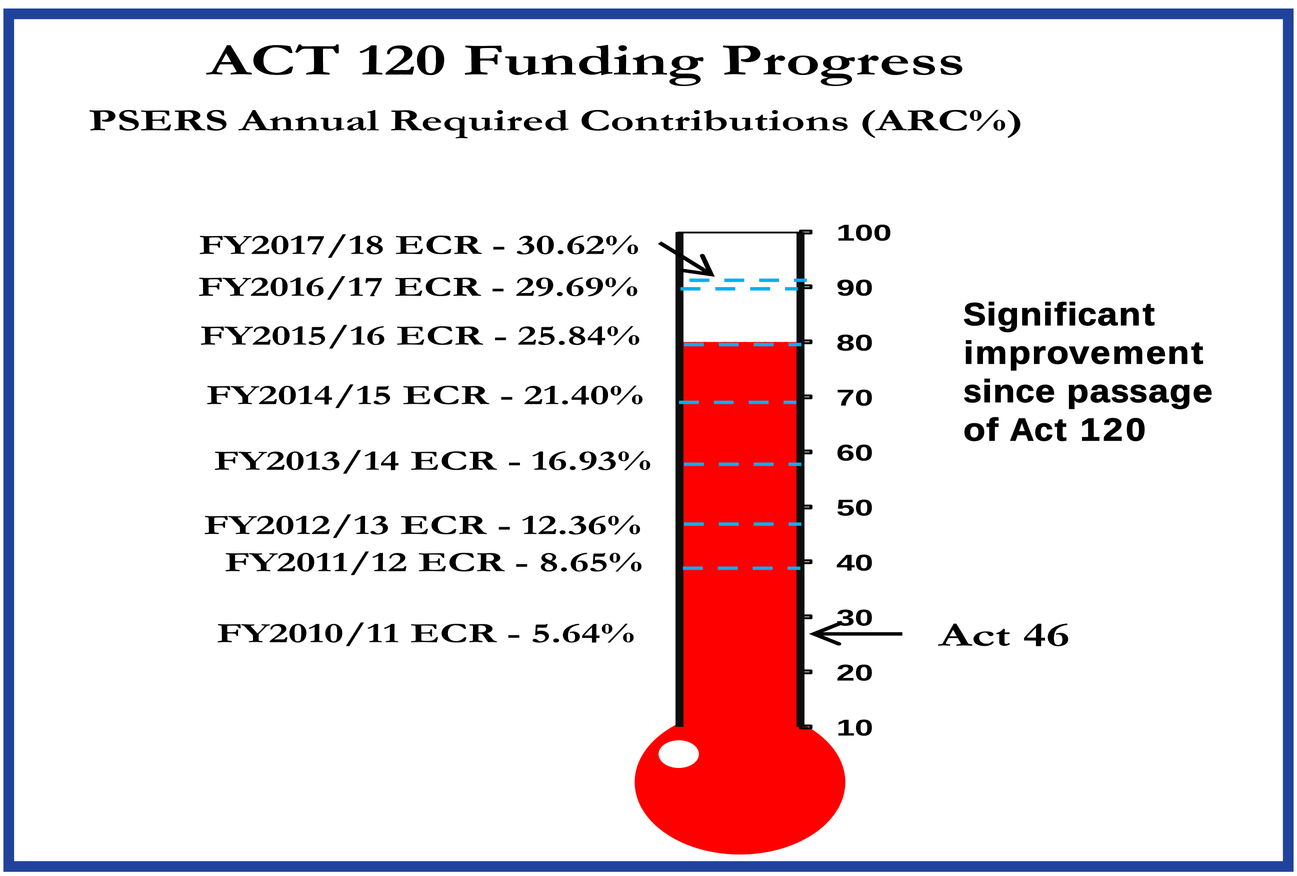
Class T-E

- Pension multiplier is 2%
- Effective July 1, 2011 employee contribution base rate is 7.5% (base rate) with "shared risk" contribution levels between 7.5% and 9.5%

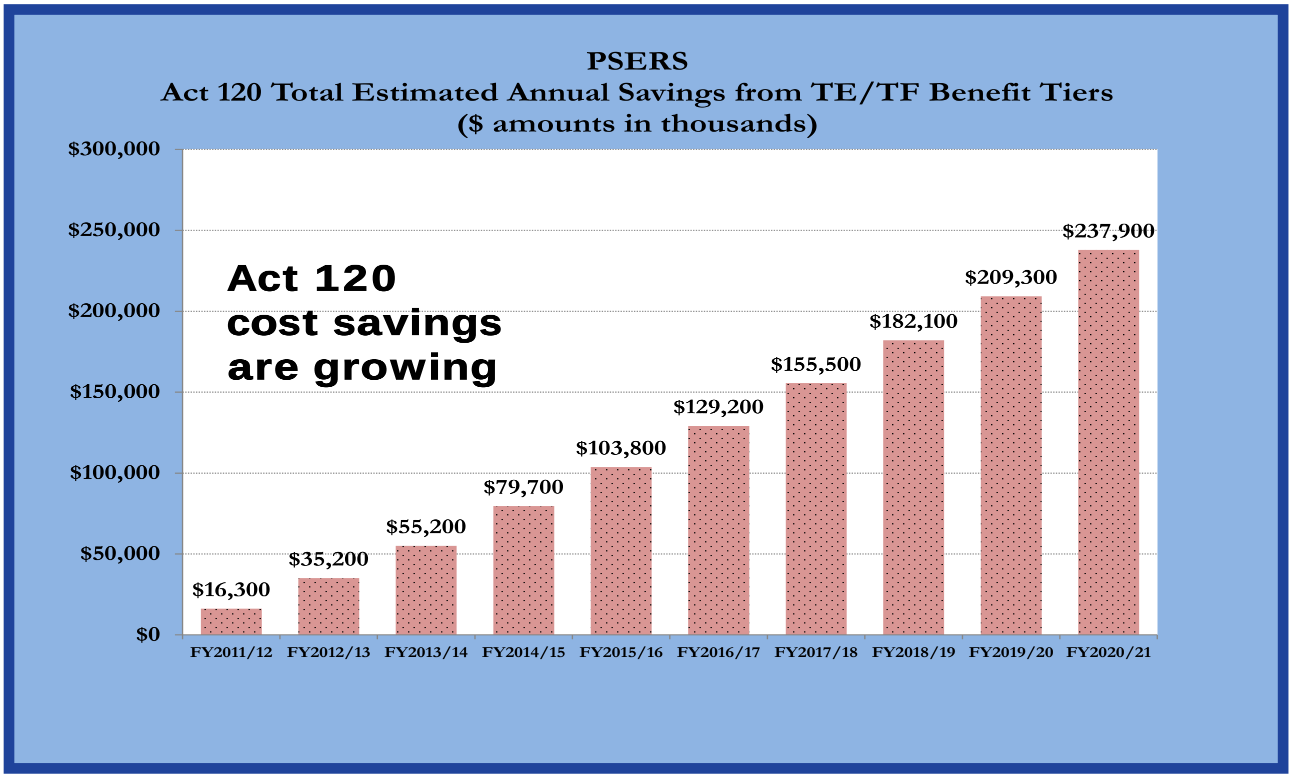
Class T-F

- Pension multiplier is 2.5%
- Effective July 1, 2011 employee contribution base rate is 10.3% (base rate) with "shared risk" contribution levels between 10.3% and 12.3%

As depicted in the thermometer chart below, the gradual rate increases under Act 120 are moving PSERS toward the 100% Annual Required Contribution (ARC) goal.



Employer Contribution Rate
(continued)



Class T-E and T-F members share some of the risk when investments underperform. As a result of the Fund's 8.66% three year return through June 30, 2014 exceeding the investment performance hurdle mandated by Act 120, the member rate will not change. The next three year investment performance measurement period for T-E/T-F members that could increase the member rate by .5% ends June 30, 2017.

The total estimated savings of the T-E/T-F Benefit Tiers is illustrated in the chart at the top of the page. As the number of T-E/T-F members grows, the savings from the low T-E/T-F cost structures also increases and allows a greater portion of employer contributions to go towards paying the unfunded liability.

As of June 30, 2014, 5,391 or 14.2% of new members elected Class T-F and 32,638 or 85.8% of new members remained in Class T-E. As indicated, Class T-F members maintain the higher 2.5% pension multiplier but contribute at a higher member contribution rate than Class T-E members.

Employer Contribution Rate
(continued)

Funding/Actuarial Changes Summary

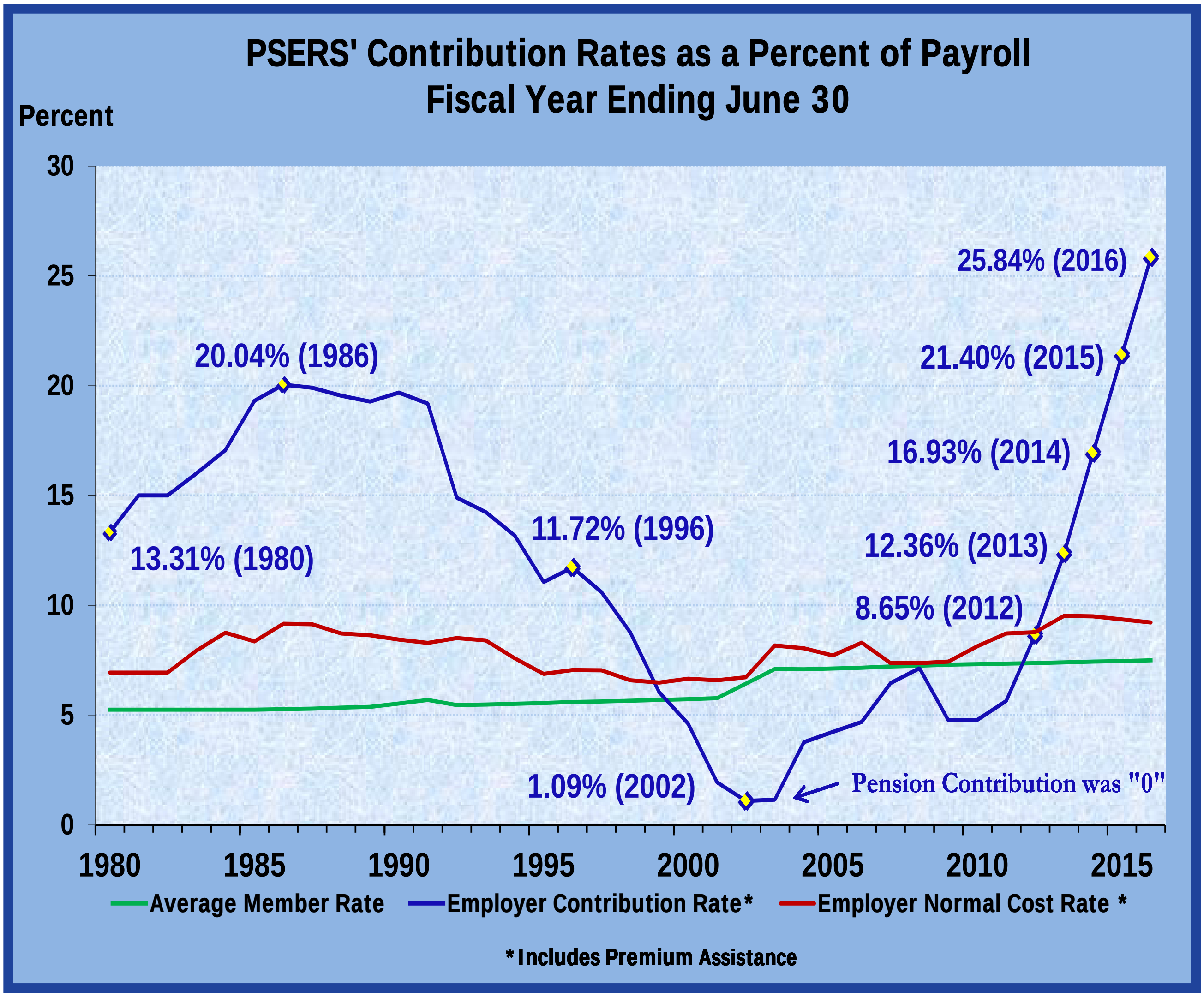
Funding Changes - Employer Contributions
Act 120 of 2010 also suppressed the employer contribution rate by using rate caps in future years to keep the rate from rising too high, too fast for budgetary purposes.

The rate caps have limited the amount the pension component of the employer contribution rate could increase over the prior year's rate as follows:

- FY2011/12 - not more than 3.0% plus the premium assistance contribution rate
- FY2012/13 - not more than 3.5% plus the premium assistance contribution rate
- FY2013/14 and thereafter - not more than 4.5% plus the premium assistance contribution rate

The rate cap remains at 4.5% until the rate cap no longer applies, i.e. the rise in the employer contribution rate is less than the rate cap in effect at that time.

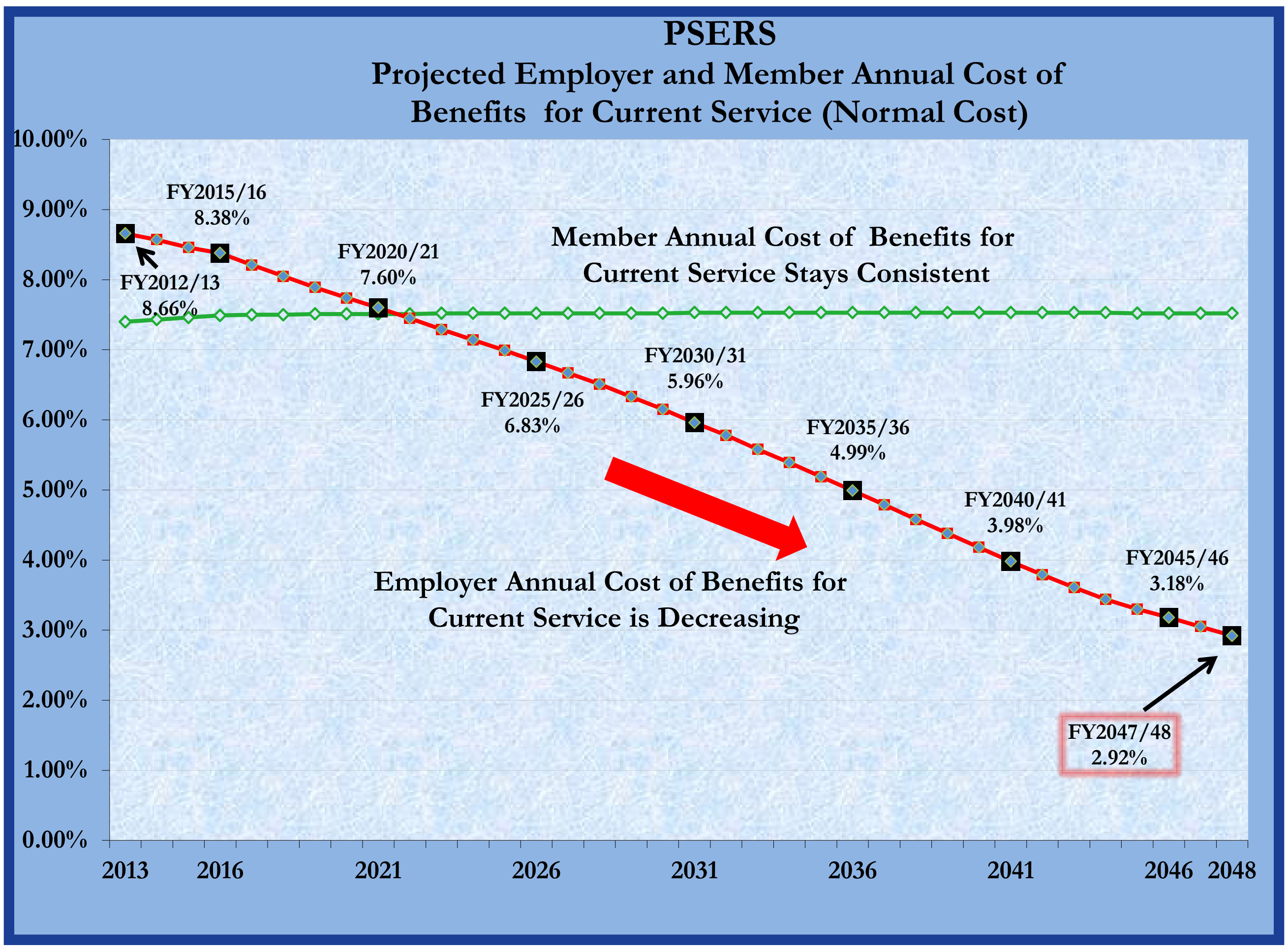
After the rate caps are no longer necessary, the actuary's recommended rate will be utilized. Based on the current projection, the rate cap will not be needed for FY2016/17. PSERS' average member rate, employer contribution rate and normal cost for the past thirty-five years are presented in the graph on the bottom of the page. The "employer normal cost" is the amount needed from the school employers to fund the benefits earned by the active members for that year.



Employer Contribution Rate
(continued)

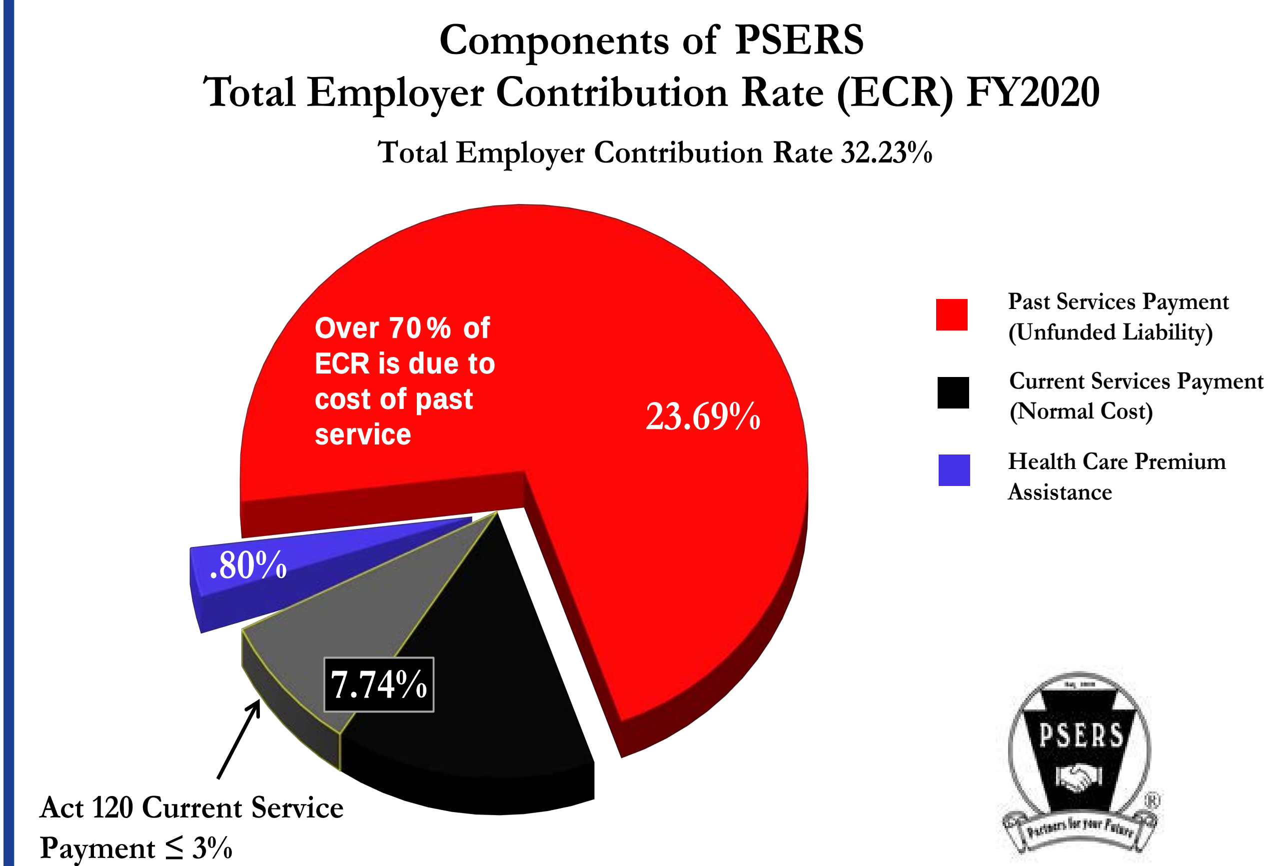
Act 120 Employer Costs
The cost structure of PSERS' new members under Act 120 is low and the shared risk provisions shift a portion of the investment risk to active members giving PSERS a defined contribution element. Essentially, Act 120 provides the members with a defined benefit plan, which is both adequate and secure, and provides the employers with a low cost employee pension benefit funded primarily by the members who have also assumed some of the investment risk.

As the chart below depicts, the employer normal cost decreases over time as Act 120 members replace retiring pre-Act 120 members. The employer normal cost of Act 120 members is less than 3% of payroll which is over 65% less than the normal cost for pre-Act 120 members. This represents a significant cost reduction for the employers. As illustrated in the chart below, the employer normal cost is projected to be 2.92% in FY2047/48 when nearly all active employees will be Act 120 members.



Employer Contribution Rate
(continued)

The chart below displays the components of PSERS' projected employer contribution rate in FY2019/20 when it is expected to peak at 32.23%. At that point in time, the majority of the rate, over 70%, is dedicated toward paying the cost of past service.



Employer Contribution Rate
(continued)

Comparison of Projected Employer Retirement Contributions Pre-Act 120 vs. Act 120

Fiscal Year Ending June 30	(A) Appropriation Payroll (in thousands)		(B) Employer Contributions Rates	(C) Pre-Act 120 Employer Contributions (in thousands)	(D)=(A)*(B) Act 120 Employer Contributions (in thousands)	(E)=(C)-(D) Budgetary Amount Deferred (in thousands)	(E)*56% (56%) State Share of Deferral (in thousands)	(E)*44% (44%) School Share of Deferral (in thousands)	% of GASB's Annual Required Contributions (ARC)
2013	$12,836,000	*	12.36%	$3,781,486	$1,586,530	**$2,194,956**	$1,229,175	$965,781	46
2014	$13,174,000	*	16.93%	$4,257,837	$2,230,358	**$2,027,479**	$1,135,388	$892,091	58
2015	$13,482,000		21.40%	$4,560,961	$2,885,148	**$1,675,813**	$938,455	$737,358	71
2016	$13,375,000		25.84%	$4,479,288	$3,456,100	**$1,023,188**	$572,985	$450,203	81
2017	$13,739,290		29.69%	$4,528,470	$4,079,195	**$449,275**	$251,594	$197,681	90
2018	$14,097,299		30.62%	$4,547,789	$4,316,593	**$231,196**	$129,470	$101,726	91
Cumulative Total Budgetary Deferral						**$7,601,907**	$4,257,067	$3,344,840	

* Updated for most recent actual payroll.

Act 120 Budgetary Deferral
As indicated previously, the funding and actuarial provisions of Act 120 have provided the Commonwealth and school employers a multi-year period to appropriate funds for PSERS' unfunded liability. Act 120 will defer a total of $7.6 billion in employer contributions from FY2012/13 through FY2017/18 as seen in the table at the top of the page. If Act 120 was not in place, the employer contribution rate would have spiked to 33.83% in FY2014/15 under previous law. That is an approximately $1.7 billion dollar difference between the 33.83% Pre-Act 120 employer rate and the 21.40% employer rate that went into effect July 1, 2014. The FY2013/14 employer contribution rate of 16.93% also resulted in a $2.0 billion reduction in employer contributions over the Pre-Act 120 contribution rate of 32.32%.

PSERS Annual Required Contributions
The schedule of employer contributions below shows historical trend information for the Annual Required Contribution (ARC) for pensions, and the percentage of the ARC contributed to the pension system. In addition, the Comparison of Employer Retirement Contributions table at the top of this page reflects projected ARC percentages through FY2017/18.

Schedule of Employer Contributions
($ Amounts in Thousands)

Fiscal Year Ended June 30	Annual Required Contribution (ARC)	Actual Employer Contribution		ARC Percentage Contributed
2014	$3,410,373	$1,986,384	*	58%
2013	$3,110,429	$1,434,815	*	46%
2012	$2,629,244	$1,001,140	*	38%
2011	$2,436,602	$647,000	*	27%
2010	$1,928,278	$527,212	*	27%
2009	$1,761,295	$503,227	*	29%
2008	$1,852,238	$753,532		41%
2007	$1,708,821	$659,545		39%
2006	$1,328,373	$456,878		34%
2005	$945,107	$431,556		46%
2004	$321,901	$321,901		100%

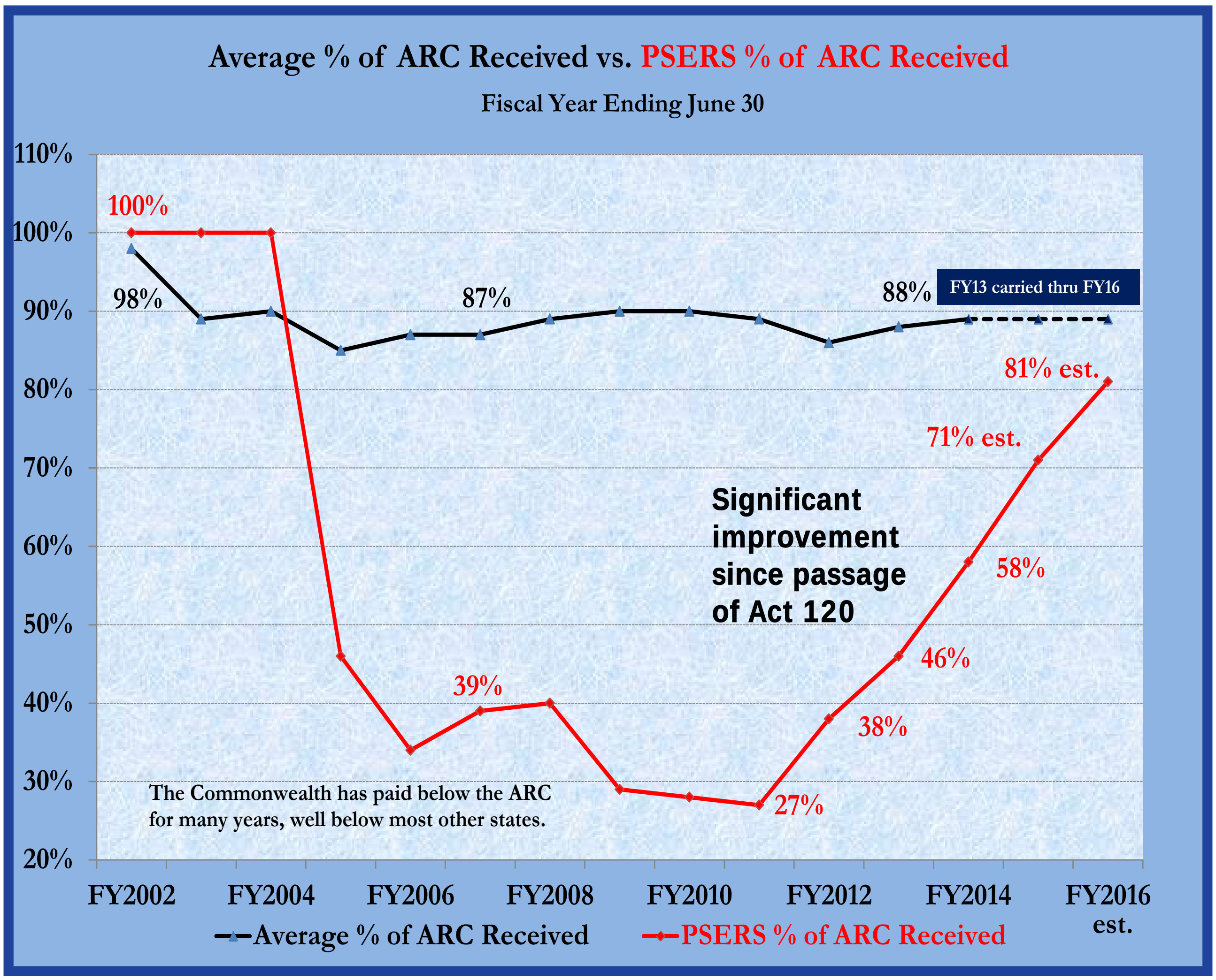
*Net of purchase of service contributions

Employer Contribution Rate
(continued)

As a consequence of the structural deficit in the Commonwealth's budget, the Commonwealth and school employers have not made the required annual payments to PSERS for the past ten years. Taxpayers, as a result, have benefited significantly from employer pension funding deferrals. However, bond rating agencies have already reduced Pennsylvania's bond rating five times and the pension funding gap was noted as one of the reasons for the decrease. If Pennsylvania does not continue to increase its contributions as provided in Act 120, the underfunding could further negatively impact bond ratings and increase PSERS' unfunded liability under GASB 67.

PSERS' Board certified an employer contribution rate of 25.84% for FY2015/16 in compliance with Act 120. As a result, PSERS' ARC percentage is projected to increase from 71% in the FY2014/15 to 81% in FY2015/16. PSERS' projected ARC percentage of 71% for FY2014/15 is well below the average ARC percentage of 89% for public funds based on the January 2015 Public Fund Survey prepared by NASRA.

The FY2015/16 contribution rate of 25.84% includes a portion to fund interest on the unfunded liability of the System. This will be the fourth consecutive year PSERS' employer contribution rate includes a portion to pay for some of the interest costs on the unfunded liability. As depicted in the chart below, the gradual rate increases under Act 120 are moving PSERS toward the 100% ARC goal. Rate increases implemented so far have moved the ARC from 27% to 81%. The funding provisions of Act 120 are working. Future projected contribution rate increases will raise PSERS' ARC percentage to nearly 90% by FY2016/17 which is slightly above the current average ARC of 89% for major public plans (NASRA). The chart at the bottom of the page shows a comparison of PSERS' percentage of ARC received to the average ARC received for large public pension plans.



Employer Contribution Rate
(continued)

Projected Impact to PSERS from $3 Billion Cash Infusion

The Governor's Budget proposal includes a $3 billion cash infusion that would have an immediate effect on the unfunded liability of the System. Not only would the System's funded ratio improve but also the employer contribution rate plateau would be reduced by 1.6%. As shown in the table below, this funding would save the Commonwealth and school districts nearly $8 billion over the next 24 years.

Pension Funding
With Impact of $3 Billion Cash Infusion
As of June 30, 2014 Actuarial Valuation

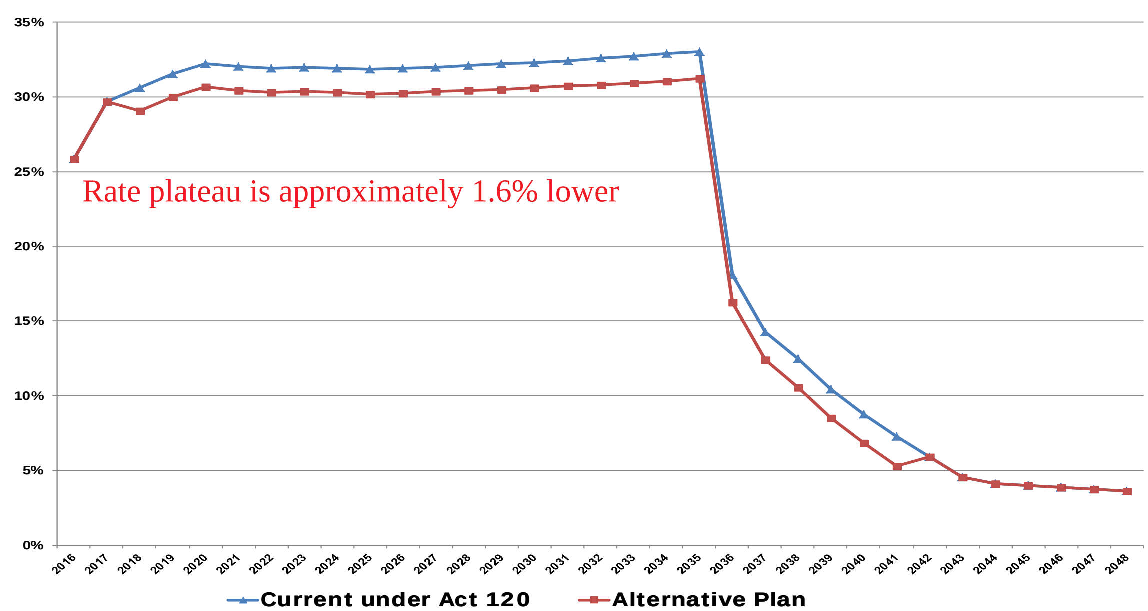
Funding Reform	Projected Savings through FY2048 ($000s omitted)	Employer Contribution Rate Plateau Level (%)	Funded Ratio Lowest Level (%)	Funded Ratio Lowest Level Fiscal Year	Unfunded Accrued Liability Peak Level ($millions)	Unfunded Accrued Liability Peak Level Fiscal Year
Current Law (June 30, 2014 Valuation)	N/A	32.00	58.4	2018	42,871	2018
Current Law w/$3.0 Billion Cash Infusion	7,915,144	30.40	60.2	2018	39,620	2018

Public School Employees' Retirement System of Pennsylvania
With Impact of $3 Billion Cash Infusion
As of June 30, 2014 Valuation

Alternative Funding Assumptions:

- One-time contribution of $3,000,000,000 is made as of 2/1/2016 and the lump sum amount is amortized over 24 years, beginning with FY2018.

Projection of Total Employer Contribution Rate



Employer Contribution Rate
(continued)

Next Steps

As noted, the Commonwealth and school employers have benefited over the past 10 years due to PSERS' very low ARC. Act 120 has significantly reduced the employer's normal cost for future new members via benefit reductions to new members, but a significant unfunded liability for service already rendered by active members still remains to be paid.

Act 120 has provided both the Commonwealth and the school employers with a multi-year time horizon to gradually increase contributions to PSERS in a more budgetarily feasible manner than the contribution rate spike under previous law. The process is now an appropriation challenge to meet the gradual funding increases provided for in Act 120 and bring the ARC percentage to a healthy level and in line with other public pension funds.

The funding issue confronting PSERS represents the greatest challenge the System has faced in its history. While Act 120 of 2010 provided historic pension reform and made dramatic progress toward addressing the funding issue at PSERS, difficult budget issues remain for both the Commonwealth and school employers.

PSERS has long stated that three events must occur to resolve the funding issue at the System: (1) pension reform must take place, (2) PSERS' investments must perform as required, and (3) a large cash infusion must be obtained to pay off the existing debt (unfunded liability) that has already been incurred but not yet paid.

Two of those items have occurred and have begun to help resolve the funding issue. Significant pension reform was enacted in 2010 and PSERS' investments have performed as required.

Act 120 of 2010 has already provided significant pension reform. Act 120 reformed the benefit structure and actuarial and funding methodologies at PSERS. The Act 120 benefit reductions are projected to save over $24.6 billion. Currently, the annual employer benefit cost for new members is less than 3.00% of payroll, which leaves very little to cut for additional meaningful benefit reform to occur.

Even with the recent increase in the employer contribution rates, an additional cash infusion and/or still higher employer contribution rates are necessary to pay down the "principal" of the existing debt in the System. Although there has been much discussion of additional pension reform as a solution to the funding issue, the impact of further benefit reductions for new members will only have a marginal impact on projected employer contribution rates. The primary question that needs to be addressed is how to pay for the higher employer contribution rates needed to reach the funding levels recommended by PSERS' actuary and begin to pay off the existing debt.

The Governor's Budget includes a $3 billion cash infusion to PSERS in FY2015/16 which would immediately improve PSERS' unfunded liability and lower the employer contribution rate plateau by 1.6%. In addition, based on current actuarial projections, in FY2016/17 the Act 120 rate collars would no longer be needed and future contribution rates begin to level off which will reduce budgetary pressure on the Commonwealth in FY2017/18 and beyond.

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Consultants' Fees
($100,000 and Over)

The following benefit, investment, information technology and financial professional service firms were under contract to provide services to PSERS during the fiscal year ended June 30, 2014.

Firm	Services Provided	Consultant Fee	
CoreSource, Inc.	Postemployment healthcare benefits administration and claims adjudication	$ 17,827,860	*
ViTech Systems Group, Inc.	Pension administration system services	$ 5,852,332	*
Rx Solutions, Inc.	Administration of postemployment healthcare benefits and prescription drug plan	$ 4,548,820	*
The Segal Company, Inc.	Actuarial services and consulting for the Health Options Program and prescription drug plan	$ 2,579,589	*
Portfolio Advisors, LLC	Private market consulting	$ 1,606,832	
Aksia LLC	Hedge fund investment consulting	$ 700,000	
Financial Control Systems, Inc.	Investment accounting application service provider	$ 633,750	
Independent Pharmaceutical Consultants, Inc.	Pharmacy benefit consulting services	$ 513,149	*
Hewitt EnnisKnupp	General investment consulting	$ 410,764	
Buck Consultants LLC	Pension benefit actuarial services	$ 378,286	*
Courtland Partners, Ltd.	Real estate investment consulting	$ 260,000	
Glass, Lewis & Co., LLC	Proxy voting	$ 169,949	
Wilshire Associates	General investment consulting	$ 164,904	

* *Amounts as reported in PSERS' Comprehensive Annual Financial Report.*

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Legislation Information

PSERS Related Legislation Enacted during the Year 2014

Other than the authorization of PSERS' Administrative Budget for FY 2014-15, no legislation affecting the operations or the membership of the Public School Employees' Retirement System was enacted during calendar year 2014.

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