Section 1 - PSERS Overview

This page intentionally left blank

Overview

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

As of June 30, 2012, the System had approximately 274,000 active members. The annuitant membership was comprised of approximately 202,000 retirees and beneficiaries who received average monthly pension benefit payments of over $406 million including healthcare premium assistance. The average yearly pension benefit paid to annuitants was $24,122. PSERS had 773 participating employers on June 30, 2012.

As reported in the latest Pension and Investments survey published February 4, 2013, PSERS is the 30th largest plan among United States corporate and public pension plans, and the 18th largest state-sponsored defined benefit public pension fund in the nation. PSERS' total plan net assets as of December 31, 2012 were approximately $49.7 billion.

During the 2012 fiscal year the overall gross distribution of pension and postemployment healthcare benefits including monthly benefits, direct rollovers, survivor benefits and refunds totaled $6.0 billion. Of this amount, 91% 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:

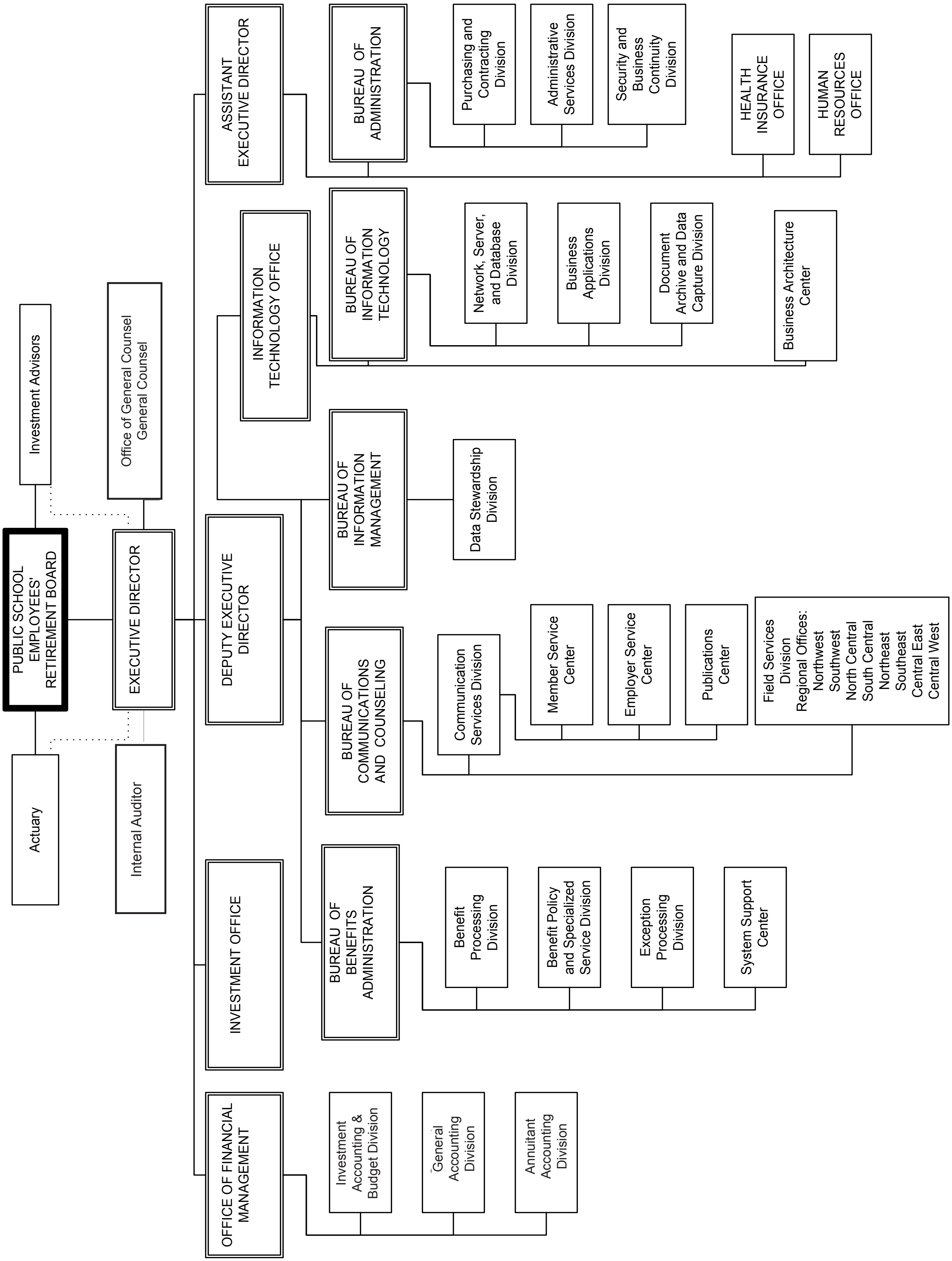
- Providing timely and accurate payment of benefits,
- Maintaining a financially sound System,
- Prudently investing the assets of the System,
- Clearly communicating members' and employers' rights and responsibilities, and
- Effectively managing the resources of the System.

This page intentionally left blank

PSERS Board of Trustees

This page intentionally left blank

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 are the Deputy Executive Director, Assistant Executive Director, Chief Investment Officer, Chief Financial Officer, Internal Auditor, Press Secretary, 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 PSERS in all administrative hearings and other litigation matters; drafting and negotiating PSERS' investment and administrative services contracts; and providing counsel on a wide variety of matters, including the interpretation of the Retirement Code and the Right-to-Know Law.

Internal Auditor's Office

This office performs systematic reviews of the various PSERS activities, testing for compliance with applicable laws, policies and procedures. The Internal Auditor makes recommendations on the improvement of PSERS' 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 accounting 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 Accounting Division, Annuitant Accounting Division, and Investment Accounting and Budget Division.

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 supervises a Chief Technology Officer who oversees business and information technology strategic planning, policy development, and implementation. The organizational units directly reporting to this position include the Bureau of Benefits Administration, the Bureau of Communications and Counseling, and the Bureau of Information Management. The position oversees the Bureau of Information Technology through the Chief Technology Officer.

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 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 office is responsible for understanding, analyzing, documenting, and improving PSERS' organization, business rules, 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, and/or technologies; and account for its organizational business rules and processes, information systems and technologies.

Organizational Structure (continued)

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 Technology Officer, and for providing operational support for those technologies and initiatives. The bureau is organized into three divisions: the Network, Server, and Database Division, the Business Applications Division, and the Document Archive and Data Capture Division.

Bureau of Information Management

This bureau is responsible for maintaining, documenting, and cleansing PSERS' member and employer data, managing PSERS' electronic data records, imaged records, paper and film/fiche records, understanding the meaning and knowing the location of its data. The bureau currently includes the Data Stewardship Division which houses PSERS' records management program, and the Data Integrity and Member Accounting section.

Bureau of Benefits Administration

This bureau is responsible for administering a comprehensive pension benefits program for PSERS. The bureau provides professional and technical services to individuals who are employed full-time and part-time in one of Pennsylvania's 773 public schools or institutions. They also provide services to retirees, their beneficiaries and persons legally authorized to act on their behalf. The bureau is organized into three divisions: the Benefit Processing Division, Benefit Policy and Specialized Service Division, and Exception Processing Division.

Bureau of Communications and Counseling

This bureau is responsible for professionally communicating accurate and timely information. The goal is to promote the understanding of PSERS' benefits and processes to the members, the employers, the Legislature, the Governor's Office, other government organizations, professional organizations, and the public. It is organized into two divisions: the Field Services Division and the Communications Services Division.

Assistant Executive Director

This position reports to the Executive Director and provides 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 is responsible for facilities, purchasing and contracting, documenting administrative policies and procedures, business continuity, automotive, mail, imaging, printing and other administrative services necessary to support agency functions. The bureau is organized into three divisions: the Purchasing and Contracting Division, the Administrative Services Division and the Security and Business Continuity Division.

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 PSERS' health insurance Premium Assistance benefits. The HOP is a voluntary program that provides group health insurance coverage for 83,000 (at January 1, 2013) school retirees, their spouses, and eligible dependents.

This space intentionally left blank

Organizational Structure (continued)

PSERS' Regional Offices
There are eight PSERS Regional Offices strategically located throughout the Commonwealth. These offices provide services to both active and retired PSERS members and 773 employers. Among these services are regularly scheduled retirement counseling meetings and other informational presentations on various topics relating to retirement benefits and programs. See map on next page.

Services provided to PSERS' Members
(by the Bureau of Communications and Counseling)

Fiscal Year	2009/10	2010/11	2011/12
Number of General Information Programs	209	206	201
Number of Members Attended	12,372	13,625	10,935
Number of Exit Counseling (small group) Sessions	909	1,084	880
Number of Members Attended	7,466	9,653	7,647
Individual Counseling Sessions	1,439	1,325	1,326
Telephone Calls Answered	233,452	243,024	241,036
Telephone Calls Out	55,200	56,576	43,583
E-Mail In	33,298	60,527	45,268
E-Mail Out	32,538	54,098	35,209

Services provided to PSERS' Members
(by the Bureau of Benefits Administration)

Calendar Year	2010	2011	2012
Purchase of Service Applications Processed	22,243	16,540	21,938
Retirements Processed			
• ***Normal and Early***	9,863	13,206	10,682
• ***Disability***	442	523	559

PSERS REGIONAL OFFICES

Public School Employees' Retirement System of Pennsylvania

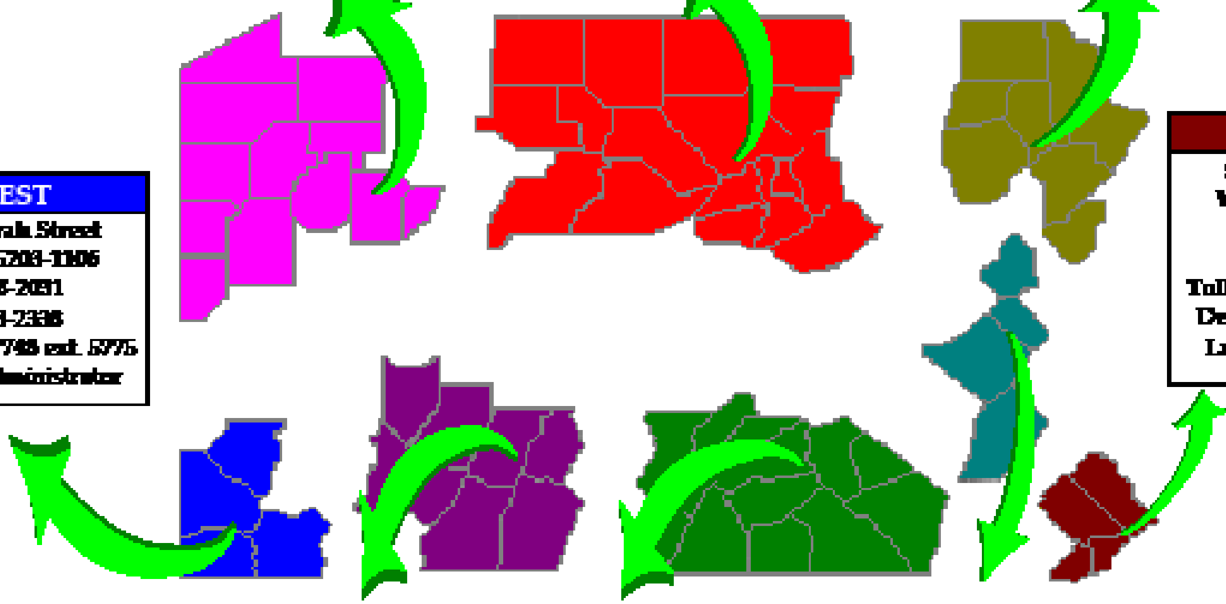
PSERS FIELD SERVICES DIVISION

Serving You in the 21st Century

NORTHWEST
Suite C, Penn Wood Center
464 Allegheny Blvd.
Franklin, PA 16323-6210
Local (814) 437-9845
FAX (814) 437-5826
Toll Free 1-888-773-7748 ext. 6176
Donald Gregory, Administrator

NORTHCENTRAL
Suite 201
300 Bellefonte Avenue
Lock Haven, PA 17745-1908
Local (570) 893-4410
FAX (570) 893-4414
Toll Free 1-888-773-7748 ext. 5276
Jeremy Wible, Administrator

NORTHEAST
Suite 201
417 Lackawanna Avenue
Scranton, PA 18503-2013
Local (570) 614-0269
FAX (570) 614-0278
Toll Free 1-888-773-7748 ext. 5376
Sherry L. Hoxie, Administrator



SOUTHWEST
Suite 208, 500 Sarah Street
Pittsburgh, PA 15203-1106
Local (412) 488-2081
FAX (412) 488-2338
Toll Free 1-888-773-7748 ext. 5775
Russell J. Miller, Administrator

SOUTHEAST
Suite 500, 605 Louis Drive
Warminster, PA 18974-2826
Local (215) 443-3495
FAX (215) 443-3487
Toll Free 1-888-773-7748 ext. 6676
Deborah Puskas, Administrator
LuAnn Rowan, Administrator

CENTRALWEST
219 W. High Street
Ebensburg, PA 15931-1540
Local (814) 419-1180
FAX (814) 419-1189
Toll Free 1-888-773-7748 ext. 5875
Brian Farester, Administrator

SOUTHCENTRAL
5 N 6th Street
Harrisburg, PA 17101-1905
Local (717) 720-6335
FAX (717) 783-9606
Toll Free 1-888-773-7748 ext. 6335
Mary James, Administrator

CENTRALEAST
Suite 103, 110 West Arch Street
Fleetwood, PA 19522-1321
Local (610) 944-9113
FAX (610) 944-9275
Toll Free 1-888-773-7748 ext. 6475
Lisa A. York, Administrator

This page intentionally left blank

PSERS' Member Demographics and Economic Information

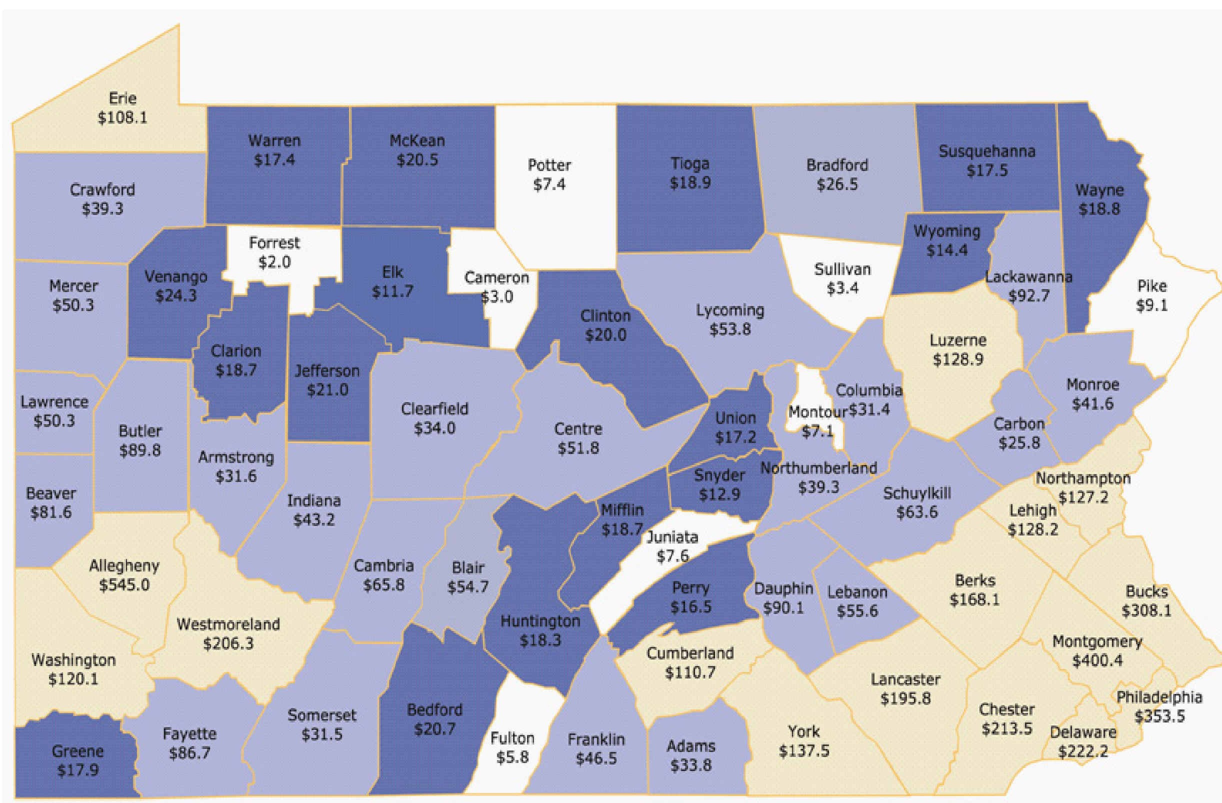
Economic Impact of Pension Benefits
In calendar Year 2012, PSERS pension disbursements to retirees totaled nearly $5.7 billion, of this amount, nearly 91%, or $5.2 billion, went directly into state and local economies. Pension benefits received by retirees are spent in the local community, and support thousands of jobs.

The map below shows PSERS pension benefit disbursements by county for calendar year 2012.

Top 10 Counties Based on Amount of Disbursements to Retirees from PSERS (Millions)	
Allegheny	$545.0
Montgomery	$400.4
Philadelphia	$353.5
Bucks	$308.1
Delaware	$222.2
Chester	$213.5
Westmoreland	$206.3
Lancaster	$195.8
Berks	$168.1
York	$137.5

$100 million+
$25 - $99.9 million
$10 - $24.9 million
$0 - $9.9 million

Public School Employees Retirement System Total Pension Benefit Disbursements by County for CY 2012 (millions)



PSERS' Member Demographics and Economic 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
2012	273,504	122,286	202,015	475,519	1.35 to 1	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
2004	247,901	72,014	151,552	399,453	1.63	471,467
2003	246,700	65,453	145,693	392,393	1.69	457,846

Age and Service Profile of Active Members

	June 30, 2011	June 30, 2012
Average Age	44.5 years	44.7 years
Average Years of PSERS Service	10.4 years	10.7 years
Average Annual Compensation	$46,247	$46,487

Profile of PSERS' Annuitants, Beneficiaries, and Survivor Annuitants

Type of Member	Number of Members		Average Annual Benefit	
	6/30/2011	6/30/2012	6/30/2011	6/30/2012
Normal/Early Retirees	175,636	182,254	$25,094	$25,323
Survivor Annuitants	10,957	11,455	$9,547	$9,731
Disability Retirees	8,029	8,306	$17,294	$17,604
Total	194,622	202,015	$23,897	$24,122

PSERS' Member Demographics and Economic Information (continued)

PSERS Pension Plan Changes in Net Assets
10 Year Cumulative Summary
(Dollar Amounts in Millions)

			Cumulative 10 Year Total
			January 1, 2003 - December 31, 2012
Balance of Net Assets (01/01/03)			**$ 39,638**
Member Contributions	$ 8,972		
Employer Contributions	5,999		
Net Investment Income	39,732		
Total Deductions - Benefits & Expenses	(44,887)		
Net Increase			**$ 9,816**
Balance of Net Assets (12/31/12)			**$ 49,454**

Cash Flow
Fiscal Years Ended in June 30
(Dollar Amounts in Millions)

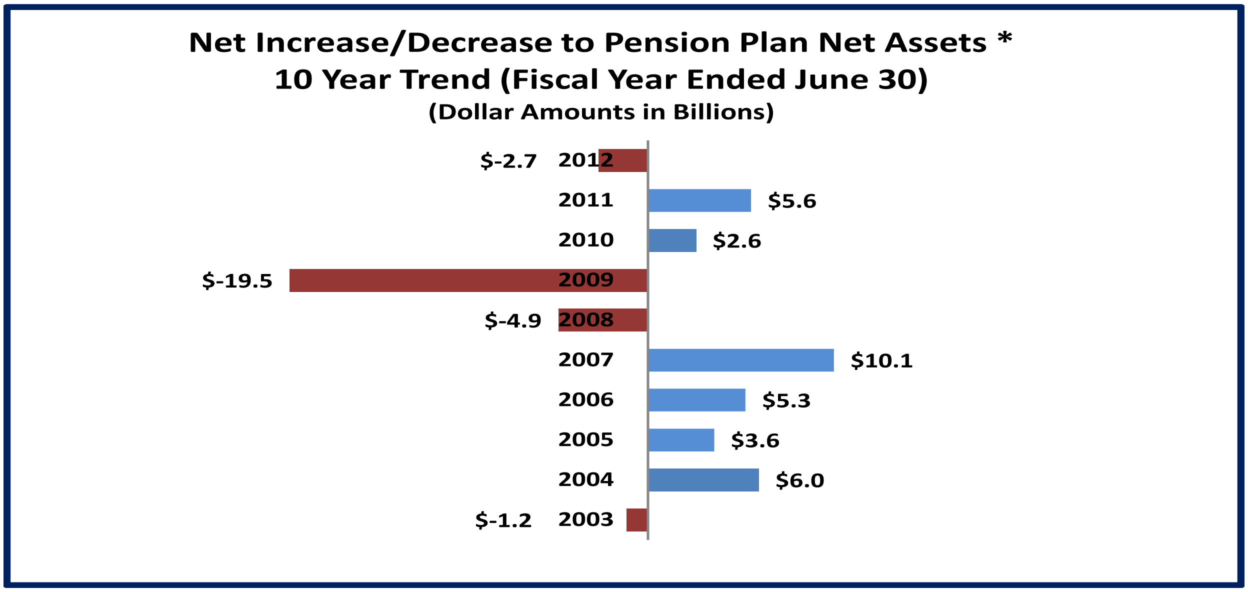
	2012	2013	2014
Member Contributions	$ 953	$ 986	$ 1,020
Employer Contributions	1,005	1,500	2,200
Total Contributions	**$ 1,958**	**$ 2,486**	**$ 3,220**
Less:			
Pension Benefits	5,655	6,000	6,400
Negative Cash Flow	**$ -3,697**	**$ -3,514**	**$ -3,180**
Beginning of Year Total Assets	**$ 51,200**	**$ 48,534**	**$ 48,706**
Negative Cash Flow (NCF) % of Total Assets	**-7.1%**	**-7.2%**	**-6.5%**
Average NCF% of Total Assets (Public Funds)	**-2.8%***		

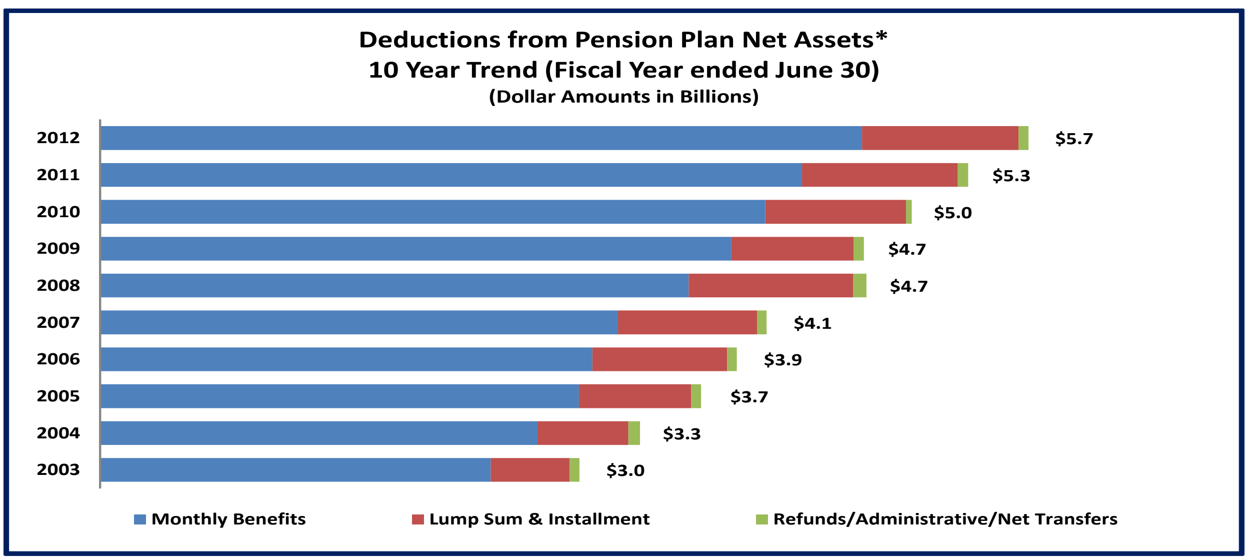
*Based on the November 2012 Public Fund Survey prepared by the National Association of State Retirement Administrators (NASRA).

Negative Cash Flow
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 -$29.9 billion during that time period. For the FY Ended June 2012, PSERS' NCF percentage is -7.1% which is twice the public fund average. Due to the projected increase in contributions through FY2013/2014, PSERS' projected NCF percentage declines to -6.5% but still remains over twice the -2.8% average of public funds*.

As a result of the large negative cash flow, PSERS has to sell a large 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 not grow until the employer contribution rates increase.

PSERS' Member Demographics and Economic Information (continued)





*Does not include PSERS Postemployment Healthcare Plan Net Assets.

The Actuarial Process and Pension Plan Funding

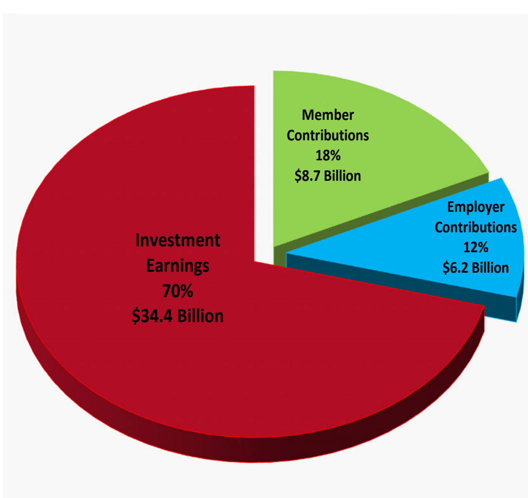
PSERS is a defined benefit plan, meaning benefits are based on members' service and salary history. The following information highlights the actuarial process and funding for PSERS.

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.

PSERS Sources of Funding
Ten Year History (2003 to 2012)



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 ten-year period ended June 30, 2012 investment earnings provided 70% of PSERS' funding followed by 18% from members. Employers contributed 12%, the smallest of the three sources.

Employer Contributions

The Retirement Code vests the 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, 2012 was 8.65%, including 0.65% for healthcare premium assistance. The total employer contribution rate for the year ending June 30, 2013 is 12.36%. This rate consists of an 11.50% pension rate (FY2011/12 pension rate of 8.00% plus the Act 120 3.50% collar) plus the healthcare premium assistance contribution of 0.86%. The FY2013/14 employer contribution rate is 16.93%. This rate consists of a 16.00% pension rate (FY2012/13 pension rate of 11.50% plus the Act 120 4.50% collar) plus the healthcare premium assistance contribution of 0.93%. The Board of Trustees certified this rate that was calculated in accordance with the provisions of Act 120 of 2010 at their December 2012 meeting. Without the Act 120 collar the employer contribution rate would be 24.75% in FY2013/14.

For the fiscal year ended June 30, 2012, PSERS' employer contributions totaled $1.086 billion, which includes $81 million for healthcare premium assistance. For the fiscal year ending June 30, 2013 the employer contribution estimate is $1.646 billion, reflective of the 12.36% contribution rate. The contribution rate for the fiscal year ending June 30, 2014 is 16.93% which results in an employer contribution estimate of $2.322 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. The average contribution rate payable by the members for the current year (FY2012/13) is 7.40%.

The Actuarial Process and Pension Plan Funding
(continued)

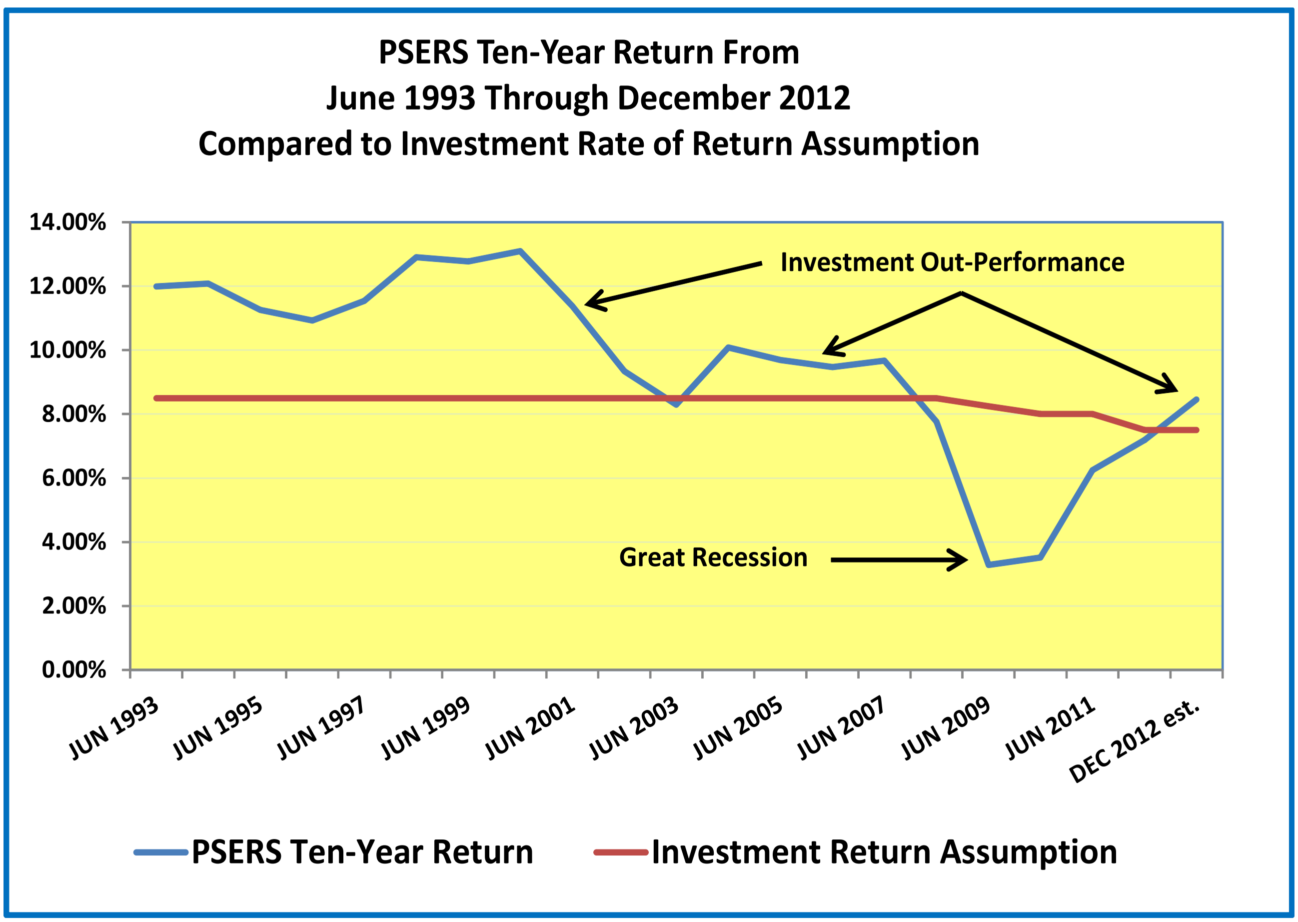
In accordance with Act 120 of 2010, any employee who becomes a member after June 30, 2011 is a Class T-E member or, alternatively, can elect to become a Class T-F member. The base contribution rate for Class T-E members is 7.50% of compensation. The base contribution rate for Class T-F members is 10.30%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

PSERS members contributed $953 million for pension contributions for FY2012. Total member contributions are estimated to be $986 million for the year ending June 30, 2013 and $1.020 billion for the fiscal year ending June 30, 2014.

The investment rate of return (net of fees) for the fiscal years ended June 30, 2012 and June 30, 2011 was 3.43% and 20.37%, respectively. The annualized rates of investment return for the three, five and ten-year periods ended June 30, 2012 were 12.57%, 0.37% and 7.19% respectively. The estimated investment rates of return for the one, three, five and ten-year periods ended December 31, 2012 were 11.39%, 9.90%, 0.90% and 8.45%, respectively. Over the past 25 years ended December 31, 2012 the Fund earned an estimated annualized rate of return of 8.91% which exceeded the Fund's long term investment rate of return assumption during that time period.

PSERS' ten-year return as shown in the chart at the bottom of the page has exceeded the actuarial investment rate of return for 15 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 employers contribution rates and/or contribution rates lower than the annual normal cost of benefits for most of those two decades. As a result of negative returns during the Great Recession, PSERS ten-year return dropped below the investment return assumption for several years. As a result of strong performance since the Great Recession, PSERS ten-year return once again exceeds its rate of return assumptions.

Investment Returns



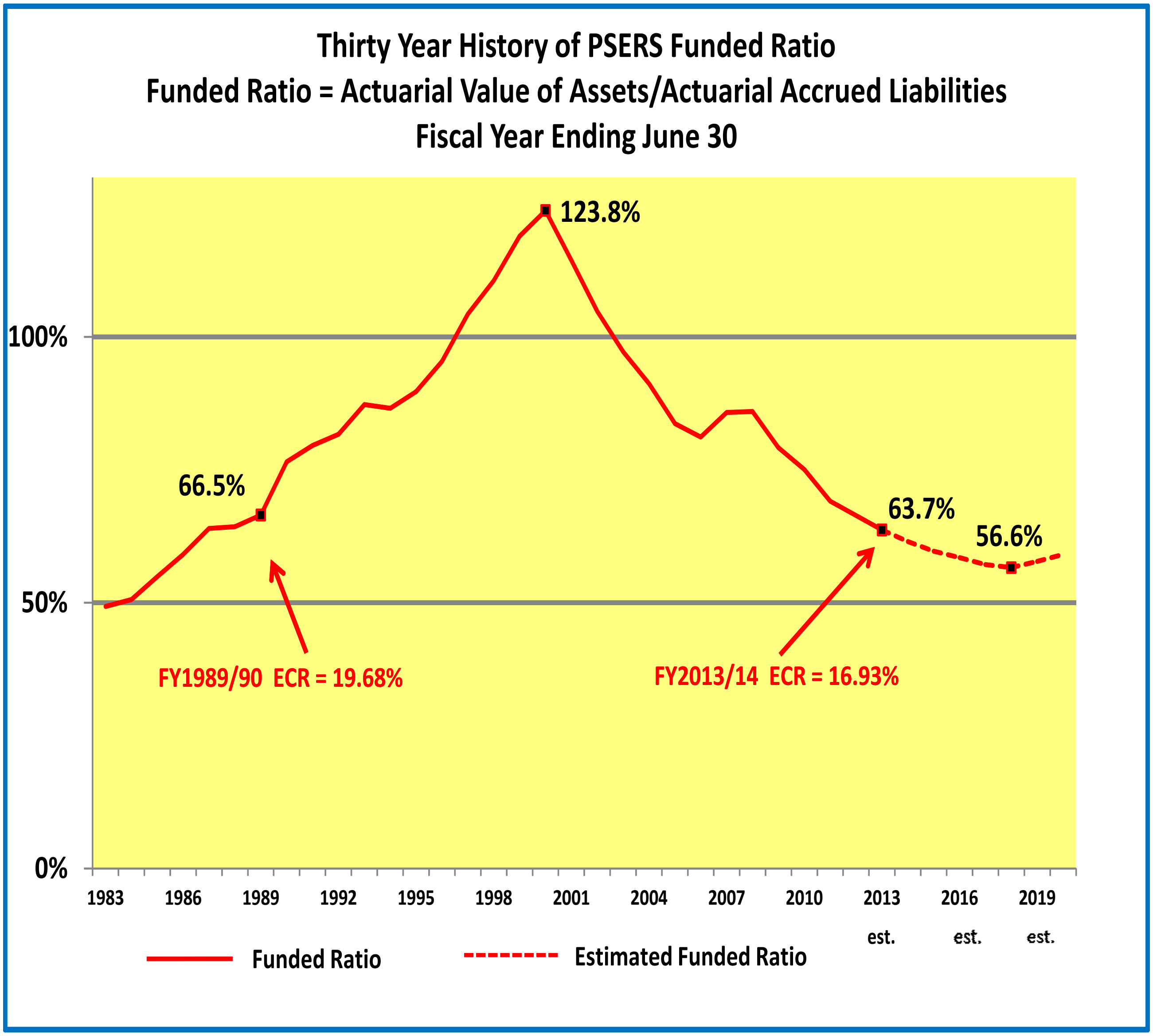
The Actuarial Process and Pension Plan Funding (continued)

Funded Status

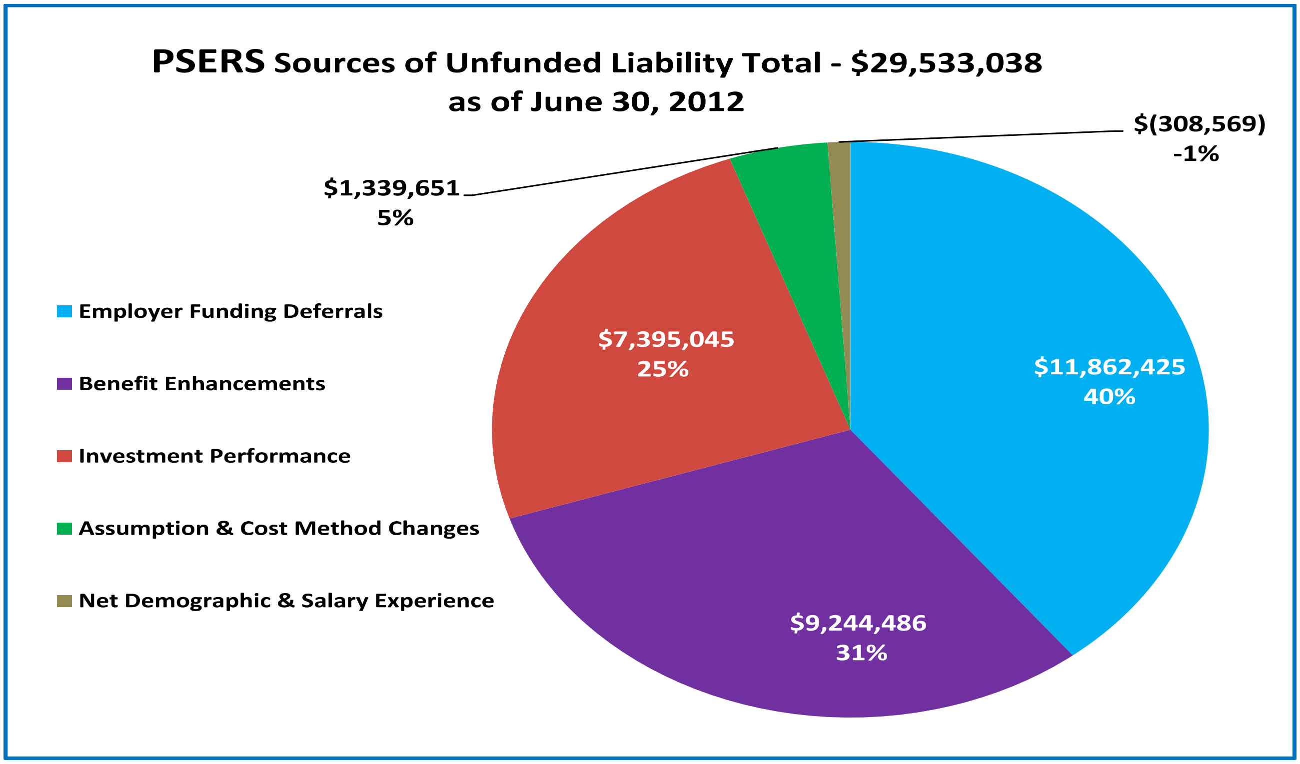
PSERS funded status is measured by comparing the actuarial value of assets with the accrued liability. The accrued liability is the present value of benefits accumulated to date for both active and retired members.

Key Facts

- Funded Status: 66.4% as of June 30, 2012
- Funded Status: 69.1% as of June 30, 2011
- The decrease in FY2012 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 collars, employers under funded PSERS by $1.5 billion in FY2012.
- 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)



Sources of Unfunded Liability

The system's total funded ratio (for Pensions and Health Insurance combined) is 66.4% as of June 30, 2012. This funded ratio is based on an actuarial value of assets of $58.4 billion and an accrued liability of $87.9 billion which equates to a $29.5 billion unfunded liability. The chart above depicts the sources of the unfunded liability. The largest sources of unfunded liability in order of magnitude are employer funding deferrals (40%), benefit enhancements (31%), which include Act 9, cost of living increases and early retirement incentives, and investment performance (25%). 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, 2012, is now close to its return assumption. Without the investment out-performance to compensate, the employer funding deferrals and benefit enhancements have significantly increased PSERS unfunded liability. Over 71% of PSERS June 30, 2012 unfunded liability is due to employer funding deferrals and benefit enhancements.

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 replaces 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 will significantly change 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.

Statement No. 68 will require cost-sharing governments (employers) to report a net pension liability, pension expense, and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the employers in the plan. Additionally, all government employers participating in the plan will be required to include plan information in their note disclosures and RSI schedules.

Statement No. 67 will take effect for pension plans in fiscal years beginning after June 15, 2013. Statement No. 68 will take effect for employers and governmental nonemployer contributing entities in fiscal years beginning after June 15, 2014. Statements Nos. 67 and 68 are available for download at no cost from the GASB website, www.gasb.org.

This space intentionally left blank

This page intentionally left blank

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 (FY1985/86) 20.04%
- Lowest historical ECR (FY2001/02) 1.09%
- Ten yr. avg. ECR (2003/04 to 2012/13) 6.25%
- Twenty yr. avg. ECR (1993/94 to 2012/13) 6.63%
- Thirty yr. avg. ECR (1983/84 to 2012/13) 10.25%
- Adopted ECR (FY2013/14) 16.93%

PSERS' average member rate, employer contribution rate and normal cost for thirty years is presented in the graph on the bottom of the page.

Act 120 of 2010

Progress on Funding Issue

PSERS is in the 2nd year of a mult-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 become new members of PSERS on or after July 1, 2011.

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

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

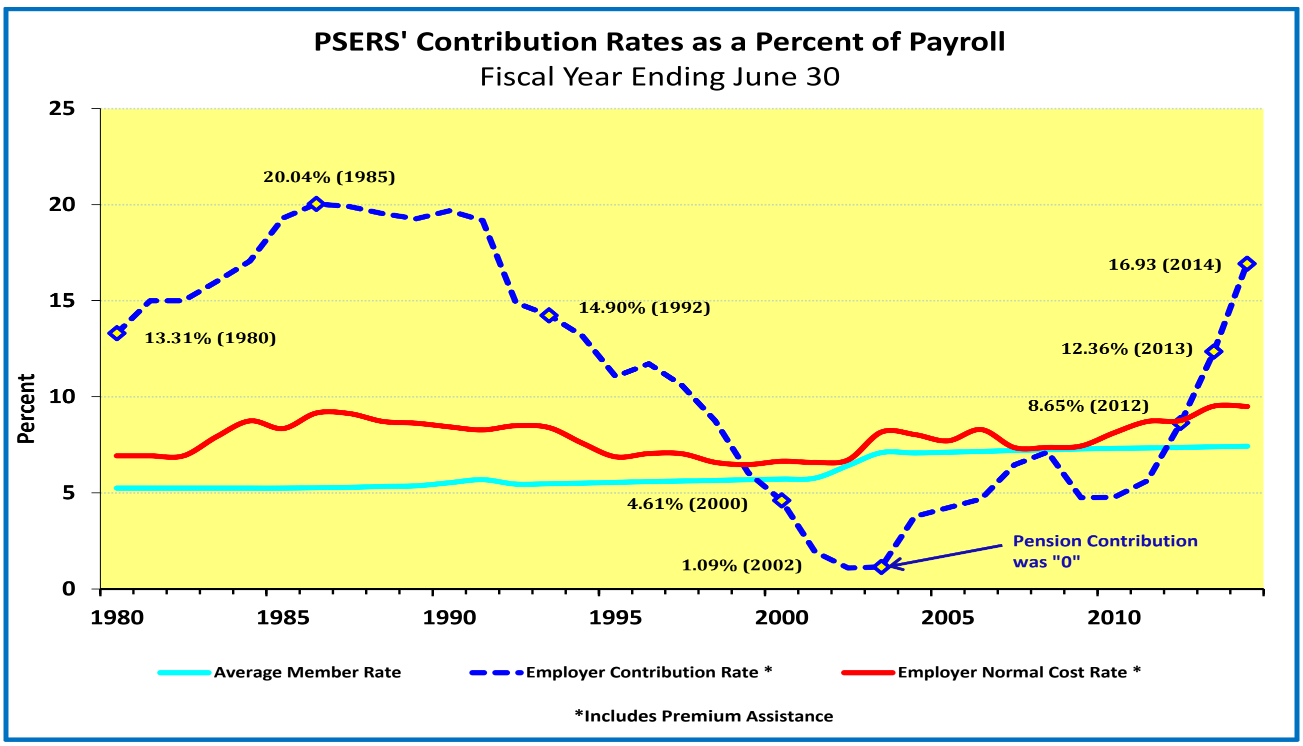
Class T-E

- 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 of December 31, 2012, 2,349 or 13.4% of new members elected class T-F and 15,223 or 86.6% of new members remained in class T-E. As indicated above, 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
The legislation 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 limit the amount the pension component of the employer contribution rate can increase over the prior year's rate as follows:

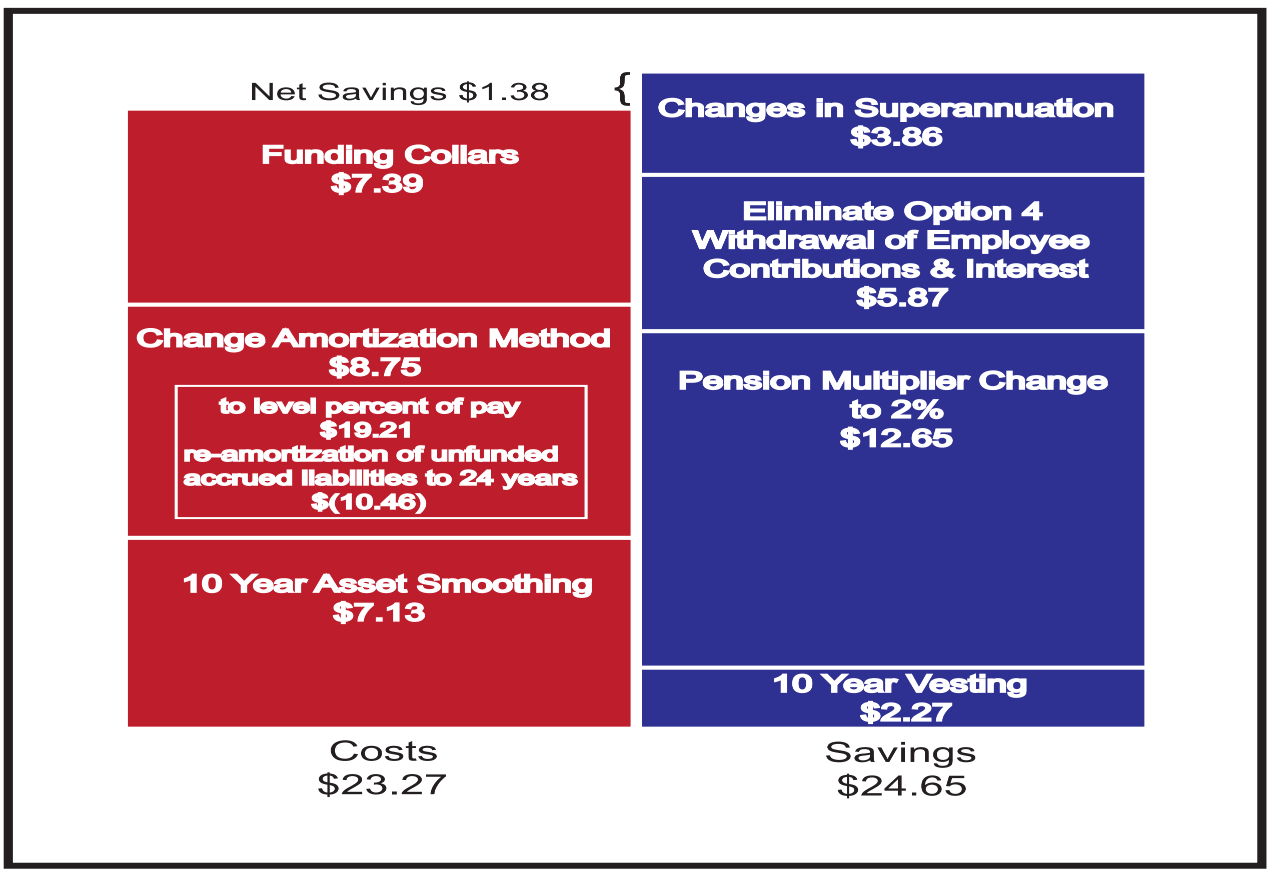
- FY2011/12 - not more than 3.0% plus the premium assistance contribution rate
- FY2012/13 - not more than 3.5% plus the premium assistance contribution rate
- FY2013/14 and thereafter - not more than 4.5% plus the premium assistance contribution rate

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.

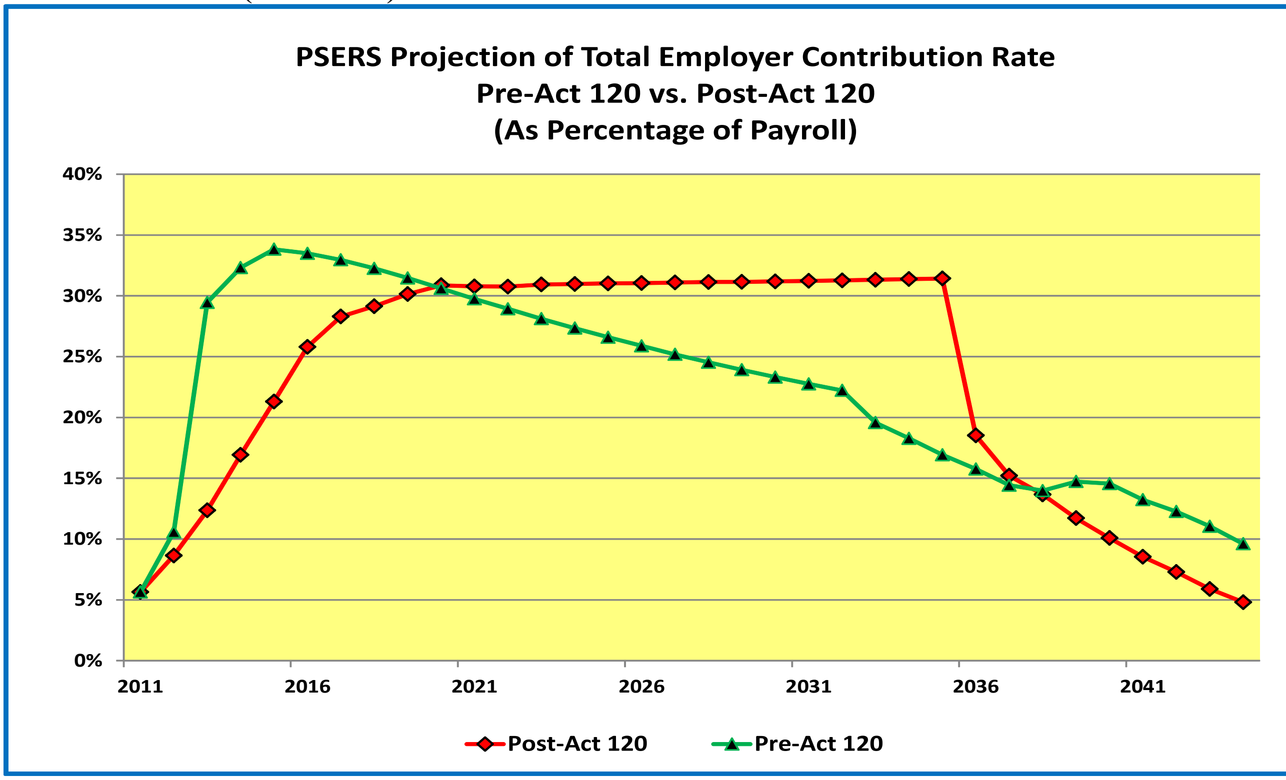
After that, the rate is what is calculated by PSERS actuary and approved by the PSERS Board, subject to a new rate floor or minimum employer contribution rate that is the employer normal cost (currently about 8%), plus the premium assistance contribution rate. The "employer normal cost" is the amount needed from the school employers to fund the benefits earned by the active members for that year.

Act 120 Costs and Savings
As depicted by the chart below, Act 120 has a projected net savings of $1.38 billion over 30 years. Act 120 benefit reductions are projected to save $24.65 billion through FY2043/44. The cost savings from benefit reductions are offset by Act 120 funding and actuarial changes. Those changes defer contributions for budgetary purposes and are projected to cost $23.27 billion through FY2043/44.

Act 120 of 2010
Costs and Savings Compared to Prior Law
Projected to FY 2043/2044
($ in billions)



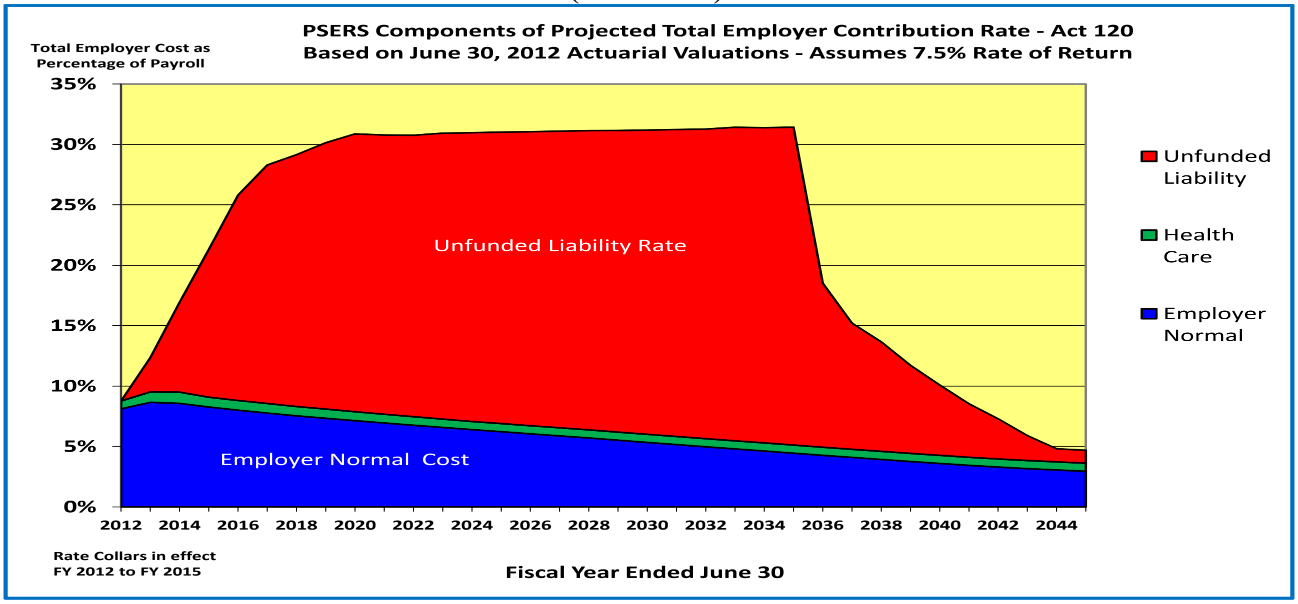
Employer Contribution Rate
(continued)



The chart above shows PSERS' projections of total employer contribution rates under Act 120 compared to previous law (Pre-Act 120). As depicted in the chart, Act 120 smooths the rate spike under previous law over nine years. The rate spike under previous law was budgetarily prohibitive for the Commonwealth and school employers. Although the contribution levels are still significant, Act 120 gives the Commonwealth and school employers nine years to gradually absorb the necessary funding increases required to adequately fund PSERS.

This space intentionally left blank

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. The chart at the top of the page shows the components of the projected total employer contribution rate with unfunded liability, employer normal cost, and health care premium assistance. 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 depicts, the employer normal cost decreases over time as Act 120 members replace retiring pre-Act 120 members. The projected employer normal cost of Act 120 members is approximately 2.24% of payroll which is over 70% less than the normal cost for pre-Act 120 members. This represents a significant cost reduction for the employers.

Regardless of the benefit structure going forward, as depicted in the chart at the top of this page, the unfunded liability accumulated for service already rendered by active members is significant and represents a much larger cost to employers than the projected normal cost for existing and Act 120 members over the next 25 years.

Est. 1919 PSERS Partners for your Future ®

This space intentionally left blank

Employer Contribution Rate
(continued)

Comparison of Employer Retirement Contributions
Pre-Act 120 Vs. Post Act 120

Fiscal Year Ending June 30	(A) Appropria-tion Payroll (in thousands)	(B) Employer Contribution 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	$ 14,297,000	12.36%	$ 4,239,061	$ 1,767,109	**$ 2,471,951**	$ 1,384,293	$ 1,087,659	46
2014	$ 13,720,000	16.93%	$ 4,434,304	$ 2,322,796	**$ 2,111,508**	$ 1,182,444	$ 929,064	58
2015	$ 14,081,432	21.31%	$ 4,763,748	$ 3,000,754	**$ 1,762,995**	$ 987,277	$ 775,718	71
2016	$ 14,451,877	25.80%	$ 4,839,934	$ 3,728,585	**$ 1,111,349**	$ 622,356	$ 488,994	84
2017	$ 14,856,092	28.30%	$ 4,896,568	$ 4,204,275	**$ 692,294**	$ 387,685	$ 304,610	90
2018	$ 15,227,378	29.15%	$ 4,928,482	$ 4,453,356	**$ 475,126**	$ 266,071	$ 209,056	91
Cumulative Total Deferral					**$ 8,625,224**	**$ 4,830,126**	**$ 3,795,100**	

Schedule of Employer Contributions

Year ended June 30	Annual Required Contributions (ARC)	Actual Employer Contributions	ARC Percentage Contributed
2012	**$ 2,629,244**	**$ 1,001,140***	**38%**
2011	**$ 2,436,602**	**$ 646,560***	**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%**

* Net of purchase of service contributions.

Act 120 Budgetary Deferral

As indicated previously, the funding and actuarial provisions of Act 120 have provided the Commonwealth and school employers a nine year period to appropriate funds for PSERS' unfunded liability. Act 120 is projected to defer $8.6 billion in employer contributions in the next six years alone 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 32.32% in FY2013/14 under previous law. That is an approximately $2.1 billion dollar difference between the 32.32% Pre-Act 120 employer rate and the 16.93% employer rate that will go into effect July 1, 2013. The current FY2012/13 employer contribution rate of 12.36% also resulted in a $2.5 billion reduction in employer contributions over the Pre-Act 120 contribution rate of 29.65%

PSERS Annual Required Contributions

The schedule of employer contributions above 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.

The national landscape has changed and the underfunding of state pension plans has proved costly to New Jersey, Illinois, Connecticut and other states that have experienced bond ratings decreases as result of pension funding levels. As the table above shows, the Commonwealth and school employers have not made the required annual payments to PSERS for the past seven years. Taxpayers, as a result, have benefited significantly from employer funding deferrals. Bond rating agencies have already reduced Pennsylvania's bond rating one time and pension funding was noted as one of the reasons for the decrease. Pennsylvania must continue to increase its contributions to PSERS as provided in Act 120.

PSERS Board certified an employer contribution rate of 16.93% for FY2013/14 in compliance with Act 120. As a result, PSERS' ARC percentage is projected to increase from 38% in the FY2011/12 to 58% in FY2013/14. PSERS projected ARC percentage of 46% for FY2012/13 is well below the average ARC percentage of 86% for public funds based on the November 2012 Public Fund Survey prepared by the National Association of State Retirement Administrators (NASRA).

Employer Contribution Rate
(continued)

The FY2013/14 contribution rate of 16.93% includes a portion to fund the unfunded liability of the System. This will be the second consecutive year PSERS employer contribution rate includes a portion to pay for the unfunded liability. As depicted in the table at the top of the previous page, future projected contribution rate increases will raise PSERS' ARC percentage to nearly 84% in FY2015/16 which is close to the average ARC of 86 percent for major public plans according to the November 2012 Public Fund Survey prepared by the NASRA.

Next Steps

As noted, the Commonwealth and School employers have benefited over the past seven years and longer due to PSERS' very low ARC. Illinois, New Jersey, Connecticut and other states are currently dealing with the repercussions of underfunding their pension plans. Pennsylvania's bond rating was lowered one time last year and pension funding was one of the reasons for the decrease. 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. As the chart on page 26 shows, even if PSERS only paid the unfunded liability, the employer contribution rate still peaks at over 20% of payroll and remains there for over a decade.

Act 120 has provided both the Commonwealth and the School employers with a nine year time horizon to gradually increase contributions to PSERS in a more budgetary feasible manner than the 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.

On February 5, 2013 during his budget address, Governor Corbett unveiled his plan for additional pension reform. At the time this Budget document was prepared, cost data for the Governor's proposal was not available. It is PSERS' understanding that this proposal includes reducing the collars which would impact the projections in this document. As in the past, PSERS remains committed to providing all available assistance to the Governor, General Assembly and School employers to address the appropriation challenges.

This space intentionally left blank

Consultants' Fees
($50,000 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, 2012.

Firm	Services Provided	Consultant Fee	
CoreSource, Inc.	Postemployment healthcare benefits administration and claims adjudication	$ 13,046,823	*
ViTech Systems Group, Inc.	Pension administration system services	$ 5,422,005	*
Rx Solutions, Inc.	Administration of postemployment healthcare benefits' prescription drug plan	$ 4,109,161	*
The Segal Company, Inc.	Actuarial services and consulting for the Health Options Program and prescription drug plan	$ 2,631,905	*
Aksia LLC	Hedge fund investment consulting	$ 975,000	
Portfolio Advisors, LLC	Private market consulting	$ 663,333	
Financial Control Systems, Inc.	Investment accounting application service provider	$ 648,417	
Independent Pharmaceutical Consultants, Inc.	Pharmacy benefit consulting services	$ 527,691	*
Wilshire Associates	General investment consulting	$ 515,266	
Buck Consultants LLC	Pension benefit actuarial services	$ 389,471	*
Courtland Partners, Ltd.	Real estate investment consulting	$ 255,000	
Glass, Lewis & Co., LLC	Proxy voting	$ 247,837	
CliftonLarsonAllen LLP	Financial audit of pension system and postemployment healthcare programs	$ 115,000	*

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

This page intentionally left blank

Legislation Information

No legislation was enacted during the 2011-2012 Legislative Session affecting the operations or the membership of the Public School Employees' Retirement System.

This space intentionally left blank

This page intentionally left blank