

Considerations Affecting Further Pension Reform Initiatives

Prepared by the Pennsylvania State Employees' Retirement System

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Despite passage of Act 2010-120 (HB 2497, PN 4476), there continue to be calls for "pension reform" to further reduce benefits for future employees. Those arguing for more reductions point out that even with the passage of Act 120, the Commonwealth faces a steep increase in employer contributions. That is true, but cutting future benefits won't solve the problem.

That is because the projected rate increases primarily are the result of the debt that already has been incurred. This debt must be paid because it is a debt of the Commonwealth, guaranteed by the full faith and credit of the Commonwealth.

Following are some key facts regarding reforms to date and the challenges that remain.

The Legislature already has dramatically cut the cost of benefits for new employees.

Under Act 2010-120, the employer normal cost of SERS benefits for new Class A-3 members as a percentage of payroll has been reduced by more than 50% - from 9.53% to 4.69%. Act 120 also shifted the majority of the cost burden from the employers to the employees, as the following chart shows.

Normal Cost	Prior Law	Act 2010-120
Employee Contribution	6.25%	6.25%
Employer Contribution	9.53%	4.69%
Total Normal Cost	15.78%	10.94%

(Act 120 resulted in an even lower normal cost for the Public School Employees' Retirement System's (PSERS) new Class T-E membership. PSERS has stated that its T-E normal cost for is 2.98%. PSERS' employer normal cost for its new class is lower than SERS' primarily because PSERS members have an employee contribution rate of 7.5% versus 6.25% for by SERS members.)

Act 120 produced a \$1.5 billion savings for taxpayers.

The attached bar graph illustrates the fiscal impact of various provisions enacted in Act 2010-120. It shows that:

- The benefit reductions in Act 120 will save an estimated \$8.43 billion through 2043-44.
- However, the provisions to prevent a severe and immediate rate spike came with a high cost - \$6.95 billion.
- Still, the net result is that the combined benefit and funding changes in Act 120 will save the Commonwealth and other employers approximately \$1.5 billion compared to prior law.

Despite Act 120, the Commonwealth does still face a steep increase in employer contribution rates.

SERS employer contributions are expected to total about \$300 million this year. But they are expected to exceed \$1 billion by 2013-14 and top \$2 billion by 2016-17, and stay high for decades thereafter. The contribution rate, now 5% of payroll, is projected to climb into above 20% by 2014-15, peak at over 28% in 2016-17 and remain above 20% through 2031-32.

But that increase can't be prevented by further cutting future benefits.

Even if the Legislature entirely eliminated employer-funded retirement benefits for future state employees, employer contributions still would have to go up steeply.

Considerations Affecting Further Pension Reform Initiatives (continued)

SERS projects that even if future employees were to get no retirement benefit, employer contributions would hit almost \$2 billion per year by 2018-19 and remain in excess of \$1.5 billion through 2039-40.*

This is because even if no new members are enrolled, employers remain liable for the ongoing benefit accruals for current member and for paying off the already incurred unfunded liability.

That unfunded liability is a debt of the Commonwealth, backed by the full faith and credit of the Commonwealth; it must be paid.

The debt payment could be further postponed, but (as with all debt) putting off paying it increases the total cost.

** These projections are based on SERS' 8% assumed rate of return. In reality, if the plan were closed to new members it probably would be necessary to lower the assumed rate – further driving up employer costs.*

A Defined Contribution Plan is not a panacea

A DC plan might or might not be cheaper than Act 120, depending on how it was structured.

But as noted above, employer contributions must rise steeply in any event, to pay the Commonwealth's existing debt to the defined benefit plan – the unfunded liability.

Any cost of a DC plan (or any other reduced-benefit plan) would be in addition to that.

DC plans lack death and disability provisions – an especially important issue for public safety employees.

While it would be possible to offer future benefits that cost less than the Act 120 benefits, the General Assembly would need to consider how any additional reductions would impact retirement income adequacy.

(attachment)

Act 2010-120 Costs and Savings Compared to Prior Law Projected to FY 2043/44 (*\$ in billions*)

