Pennsylvania Pension System Reform

February 5, 2013

Pension Realities

- **Rising Contribution Rates and Costs:** Rapid growth in employer contribution rates to pay the unfunded liabilities plus normal costs are driving steep increases in the state's pension contributions, growing nearly 3x in the next 4 years from $1.5 billion to $4.3 billion in FY 16-17.
- **Unavoidable Cuts:** Without reform, fully meeting pension contributions will require deep cuts in the General Fund budget to core programs and services.
- **District Pressures:** School districts are facing similar budget dynamics and need relief to avoid deep cuts in local school budgets or steep property tax increases.
- **Unfunded Liability:** Current plans are only 67.8 percent funded, with unfunded liabilities of $41 billion growing to $65 billion in just a few years, assuming market performance meets expectations with the risk fully on the taxpayers if it does not.
- **No Support for Tax Increases or Spending Cuts:** No support for either raising taxes to cover pension obligations or making the spending cuts necessary in core programs or services to fully meet pension obligations.

Addressing the Problem-Goals

- Put taxpayers first – no tax increases
- Rebalance obligations to pensions and General Fund
  - Provide short-term relief to avoid deep cuts in core services and programs
- Don't kick the can down the road
  - Ensure any short-term budget relief is "paid for" by long-term reforms that produce an overall savings to the pension systems
- Ensure the problem never replicates itself
- Create a comprehensive and permanent solution that provides long term sustainability.
- Do no harm to current retirees
- Respect current employees by protecting retirement benefits already accrued

Future Employee Pension Changes

- All future employees would be in a Defined Contribution Plan
- Key DC Plan Characteristics
  - Automatic Enrollment, Mandatory Contributions
  - Investor education options
  - Short-term Vesting Period (4 years)
  - Lump sum option available on employee portion
- Shifts investment risk away from the Commonwealth and taxpayers and prevents future unfunded liabilities

Changes to Current Employees

- Neutral Option 4 Withdrawal of Employee Contribution
  - modify future monthly pension payments for employees who choose to withdraw all or a portion their contributions upon termination or retirement
- Pensionable Compensation Changes
  - Final Average Salary calculation based on 5 years
  - "NY Style Limit" – 110% of average of prior 4 years
  - Capping pensionable income at the Social Security wage base, which is $113,700 for 2013.
- Reduce Multiplier by .5% for all employees currently above 2.0 level, except for those already buying up
  - option to buy-up to retain higher multiplier

Example of Changes to Current Employee Assumes No Withdrawal of Employee Contribution

SERS member with 20 years of service as of effective date of change retires at age 60 with 30 years of total service

- Final average salary equals $50,000 under current plan
- Final average salary equals $47,000 with reforms
- Current Benefit equals 2.5% x $50,000 x 30 = $37,500

Proposed Benefit equals

- 2.5% x $50,000 x 20 = $25,000 plus
- 2.0% x $47,000 x 10 = $9,400 for total of $34,400

Example of Changes to Current Employee

SERS member with 20 years of service as of effective date of change retires at age 60 with 30 years of total service

- **Contribution balance at retirement is $80,000**
- **Contribution balance at effective date is $34,000 and accrues to $50,000 at retirement**
  - $50,000 attributable to service prior to the effective date
  - $30,000 attributable to service after the effective date

Example of Changes to Current Employee Assumes Withdrawal of Employee Contribution

SERS member with 20 years of service as of effective date of change retires at age 60 with 30 years of total service

- Current Actuarial Equivalent offset
  - Subsidized Portion: $80,000/14.29 = $5,600
  - Net Annuity: $37,500 - $5,600 = $31,900
- Proposed Actuarial Equivalent offset
  - Subsidized Portion: $50,000/14.29 = $3,500
  - Equivalent Portion: $30,000/10.42 = $2,900 for total $6,400
  - Net Annuity: $34,400 - $6,400 = $28,000
  - Lump sum amount of $80,000 is unchanged

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General Fund Relief

- Recommend tapering the contribution collars
  - Reduce rate increase from 4.5% to 2.25% for 2013-14
  - Increase rate by .5% each year until reaches 4.5% or the ARC
- Only slightly affects low point of funded status
  - Current low point of funding is 54.9% for SERS, and 58.0% for PSERS
  - Under new design, low point would be 57% for SERS and 56.6% for PSERS
  - Savings of $175 million in 2013-14

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Impact of Reform:

General Fund, Contributions Rates, and Unfunded Liability

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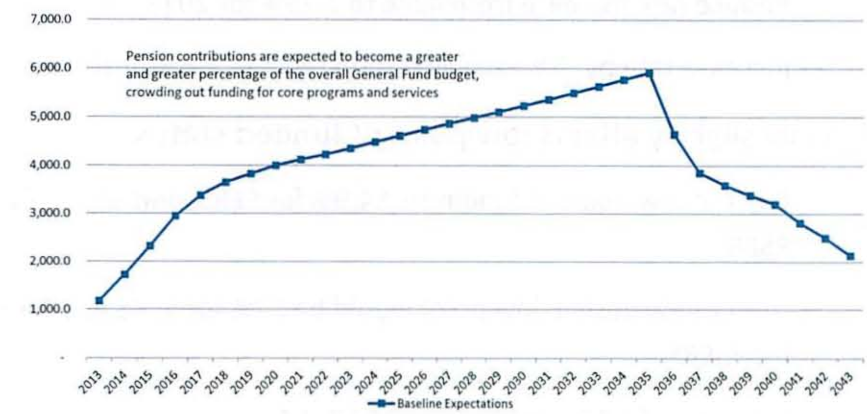
General Fund Contributions

SERS+PSERS: Projected Contribution Dollars Payable From General Fund
(Amounts in Millions)



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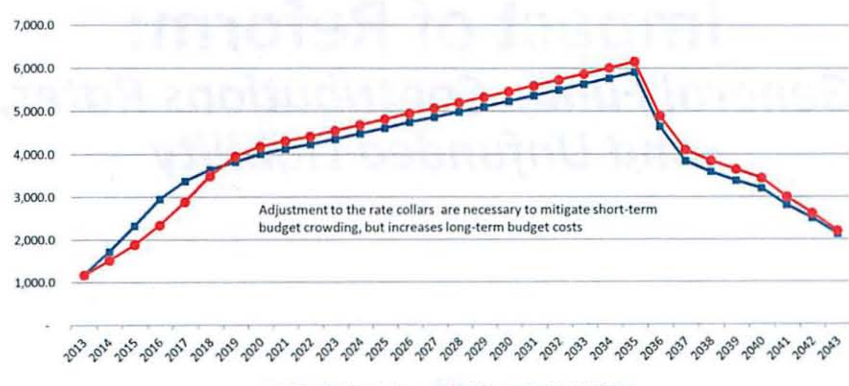
General Fund Contributions with Collar Adjustment

SERS+PSERS: Projected Contribution Dollars Payable From General Fund
(Amounts in Millions)



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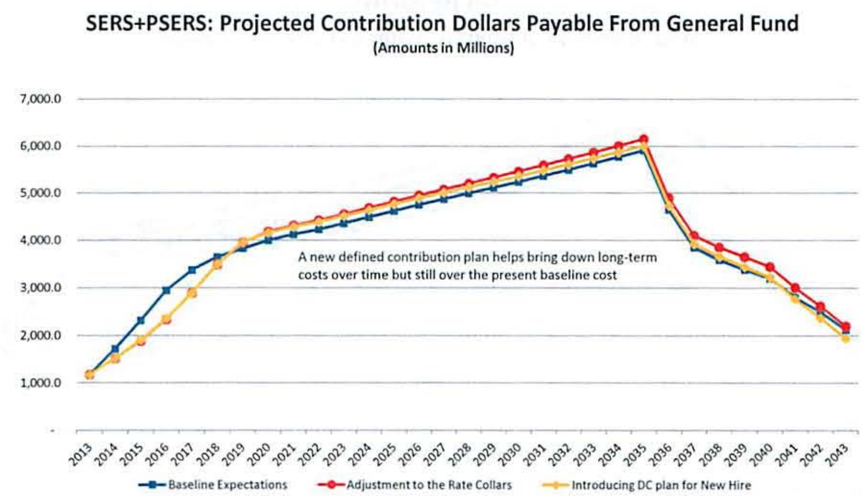
Collar Adjustment Plus Changes to New Employees



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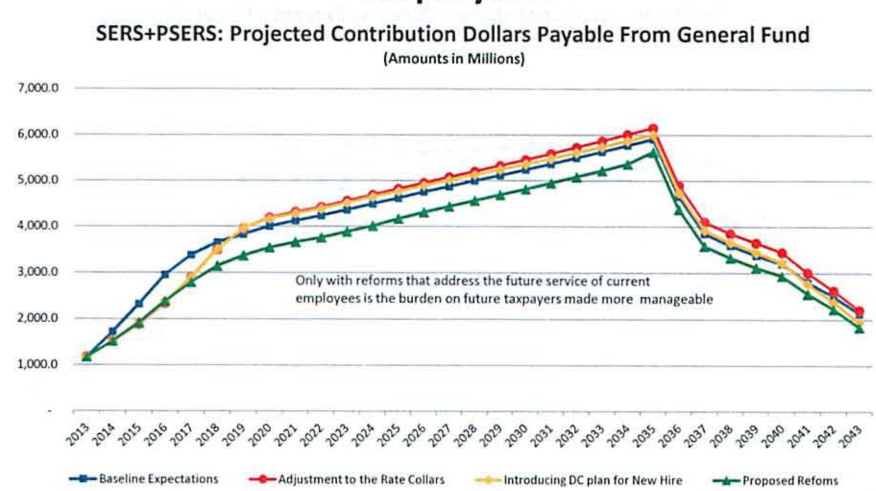
Collar Adjustment Plus Changes to New and Current Employees



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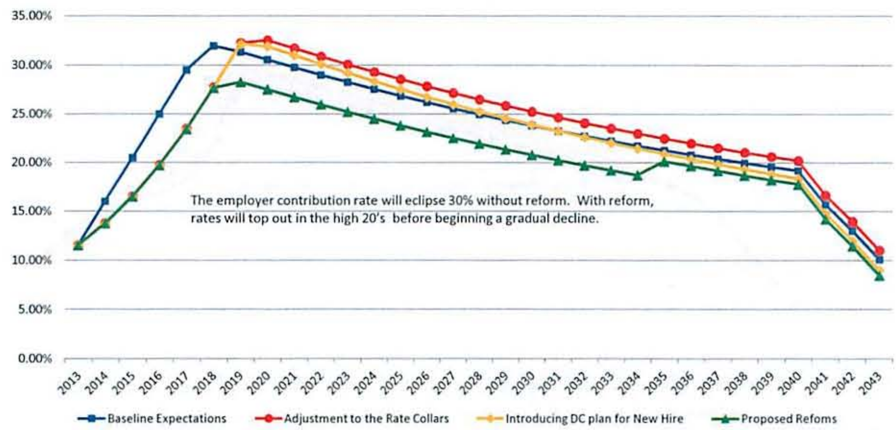
Contribution Rates SERS

All Reforms

SERS: Blended Contribution Rates as Percent of Payroll



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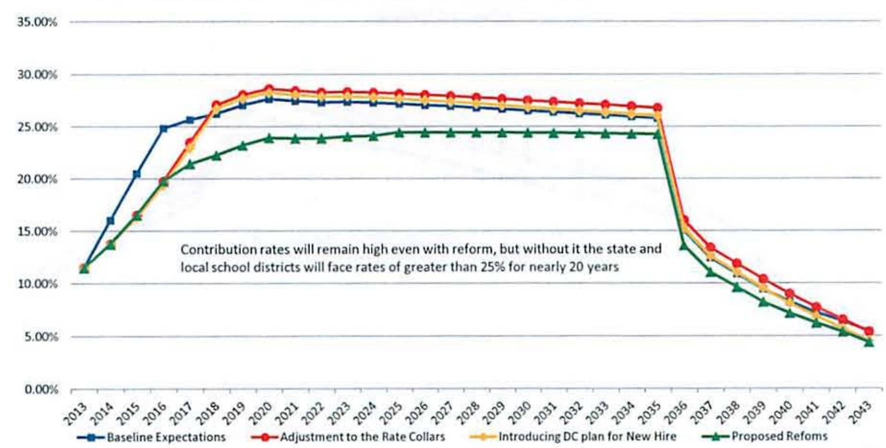
Contribution Rates PSERS

All Reforms

PSERS: Blended Contribution Rates as Percent of Payroll



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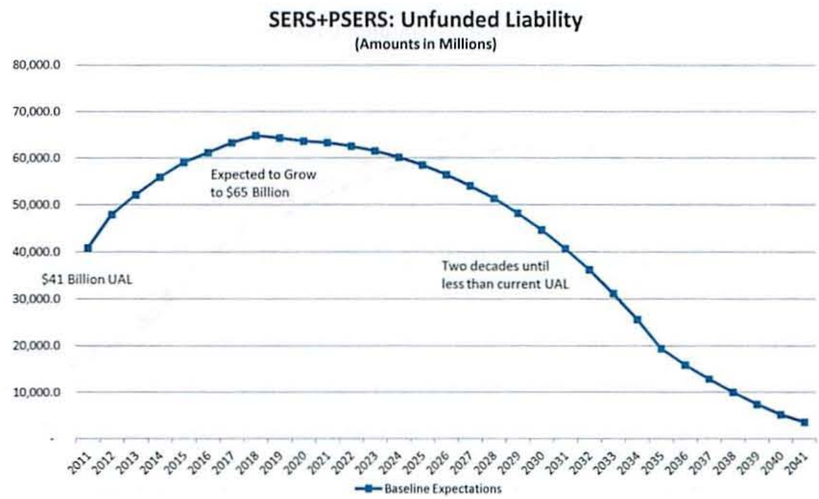
The Current Unfunded Liability Situation



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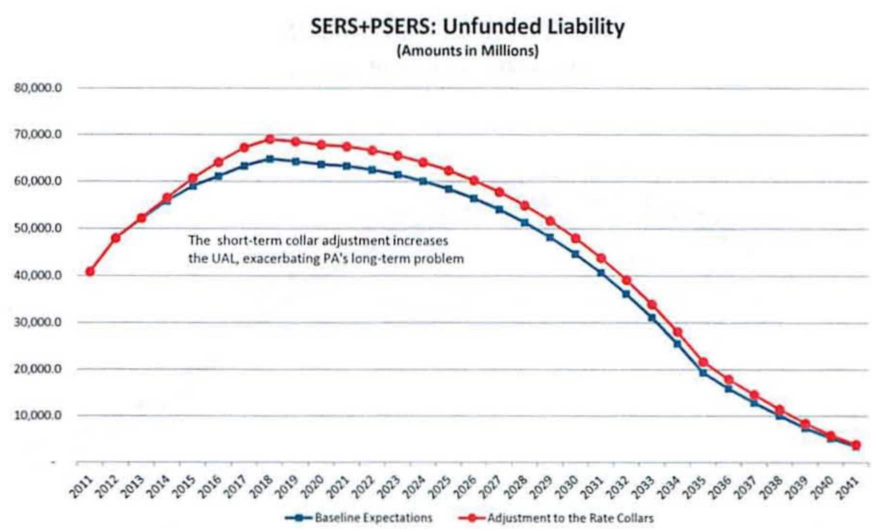
Collar Adjustment Only



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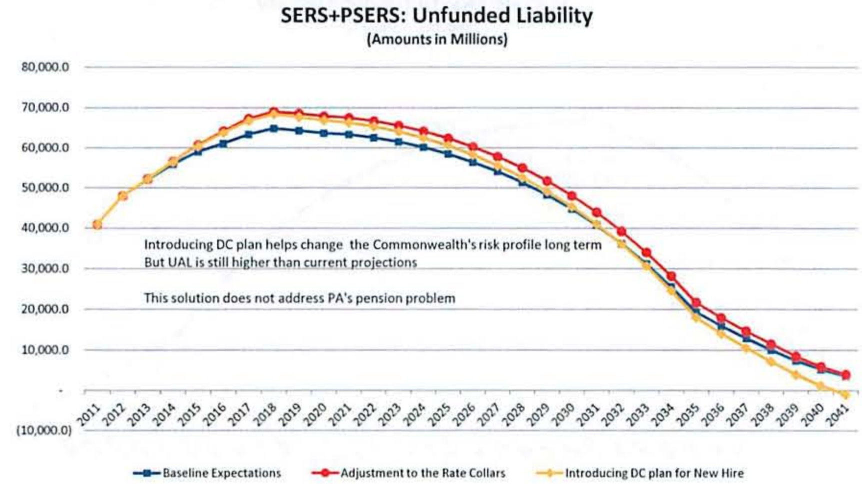
Collar Adjustment Plus DC Plan for New Employees



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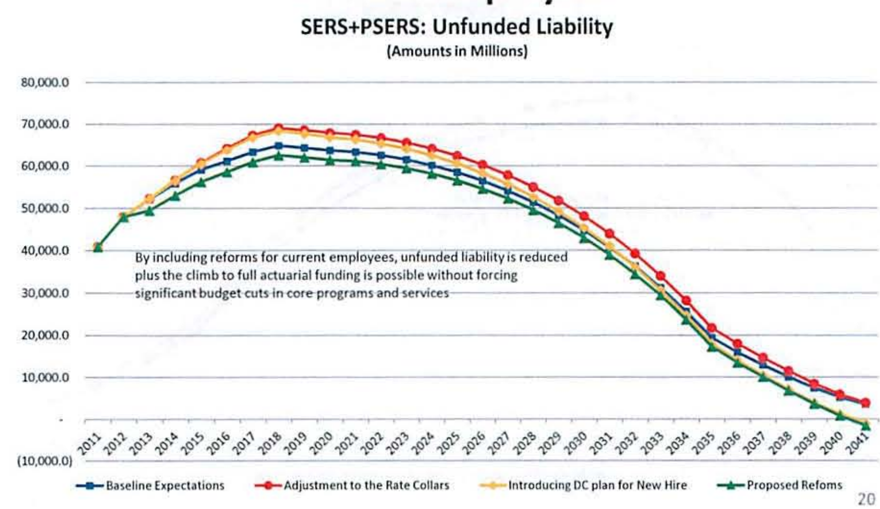
Collar Adjustment Plus Changes to New and Current Employees



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