Untangling Pennsylvania’s Pension Reform Debate
Tuesday, April 30, 2013

Introductions
Sharon Ward, Pennsylvania Budget and Policy Center

Presenters
Diane Oakley, National Institute on Retirement Security
Stephen Herzenberg, Keystone Research Center
John Raymond, PA Senate Democratic Appropriations Committee
Public Pension Reform
Policy and Efficiencies

What Does it Mean for Pennsylvania’s Future?

Tuesday, April 30, 2013

Diane Oakley
Executive Director
Important to Keep Focus on Retirement Policy

- Retirement security benefits everyone.
- Employer-sponsored retirement benefit is a workforce management tool, old-age poverty insurance, and stabilizing factor in the economy.
- As a stable employer, government is well-suited to sponsor pensions.
- Core elements of pension promote retirement security:
  - Mandatory participation
  - Employee-employer cost-sharing
  - Benefit adequacy
  - Pooled assets invested by professionals
  - Lifetime benefits

What Do Americans Think About Retirement?

Pensions and Retirement Security 2013
A Roadmap for Policy Makers
By Diane Oakley and Kelly Kenneally
February 2013

85% Concerned

Very Concerned
Somewhat Concerned
Not Too Concerned
Not At All Concerned
Strong Support for Public Pensions Because Employees Pay

To what extent do you agree/disagree that state/local employees deserve benefits because they finance cost by contributing from every paycheck?

73% Agree

- Strongly Agree: 33%
- Somewhat Agree: 39%
- Somewhat Disagree: 11%
- Strongly Disagree: 13%
- Don’t Know: 3%
Teachers Deserve Pensions to Compensate for Pay

To what extent do you agree/disagree that public school teachers deserve pension to compensate for lower pay?

72% Agree
46%
26%
14%
12%
1%

Strongly Agree
Somewhat Agree
Somewhat Disagree
Strongly Disagree
Don’t Know
Police/Fire Deserve Pensions to Compensate for Risk

To what extent do you agree/disagree that police/fire have agreed to take jobs that involve risk and therefore deserve pensions that will afford a secure retirement?

86% Agree

- Strongly Agree: 62%
- Somewhat Agree: 24%
- Somewhat Disagree: 7%
- Strongly Disagree: 6%
- Don't Know: 1%
It is not about Pension Envy -- Americans Want Pensions for All

To what extent do you agree/disagree that all workers, not just those employed by state/local governments, should have a

82% Agree

- 48% Strongly Agree
- 34% Somewhat Agree
- 9% Somewhat Disagree
- 7% Strongly Disagree
- 2% Don’t Know
DB Pension Advantage
Longevity Risk Pooling – 15% More

- Individuals must “self-insure” longevity risks – thus, the DC plan needs to set aside at least $455,000 for each retiree at age 62

- In order to fund this amount, contributions must be 16.0% of payroll
DB Pension Advantage -- Maintain Diversified Portfolio Add 5% More

- The DC plan now must have at least $485,000 set aside for each retiree at age 62.
- In order to fund this amount, contributions must be **17.0%** of payroll instead of 12.5% of payroll.
Lower Fees & Higher Returns from Professional Investment Managers

- Pensions achieve better investment returns than 401(k) type plans.
- These additional returns really add up over time and add 30 percent more to pay benefits.

How $10,000 Invested Grows over 30 Years

Source: A Better Bang for the Buck, NIRS, 2008
DB Plan Can Deliver Same Benefit at About Half the Cost of DC Plans

Source: A Better Bang for the Buck, NIRS, 2008
Switch to Individual Accounts
Not a Viable Solution

- Closing/freezing DB plans and switching to individual accounts does not address underfunding, entails significant costs.
- Majority of states ensure long-term sustainability by modifying DB plans.
- Pensions balance compensation, boost retention and productivity, and enable quality services for a lower cost.
- Hurt recruitment and retention of skilled workers, or lead to higher compensation, while undermining retirement readiness.

Source: National Institute on Retirement Security, On the Right Track
Importance of Retirement Plans to Attract Workers Under Age 40

My company’s retirement program is an important reason I decided to work for my current employer.

<table>
<thead>
<tr>
<th></th>
<th>Feb 09</th>
<th>Jun 10</th>
<th>Jun 11</th>
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<tbody>
<tr>
<td>Defined Benefit Plan</td>
<td>28%</td>
<td>43%</td>
<td>63%</td>
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<tr>
<td>Defined Contribution Plan</td>
<td>19%</td>
<td>17%</td>
<td>28%</td>
</tr>
</tbody>
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Source: Towers Watson, *Attraction and Retention; What Employees Value Most*
Importance of Retirement Plans to Retain Workers Under Age 40

My company’s retirement program is an important reason I will stay with my current employer.

![Bar chart showing the percentage of workers who consider retirement plans important over time.](chart)

Source: Towers Watson, *Attraction and Retention; What Employees Value Most*
Pennsylvania’s Pension Debate

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Pensions: the Big (National) Picture

- Half of private sector workers get no pension
- Most of the rest have an (often-lousy) 401(k)-type “defined contribution” plan
- Rising shares of the near-retired will see sharp income drops when they stop working
- The real retirement crisis is the need to improve pensions in the private sector
Pennsylvania’s Pension Debate: Outline

• How did we get here—run up a $41 billion pension debt ("unfunded liability")?
• Governor Corbett’s pension proposal
• Pensions in perspective
• Solutions
How Did We Get Here? Employer Underfunding

Figure 1. Employer and Employee Contribution Rate (percent of payroll) to the Pennsylvania School Employee Retirement System, 2001-2013

Source. Keystone Research Center (KRC) based on Pennsylvania School Employee Retirement System (PSERS) data
Employer vs. Employee Public Pension Contributions, PA & U.S. 2001 to 2011
(ratio of employee to employer contributions)
The biggest factors contributing to the PSERS unfunded liability, in order...

- Investment Losses (2002-03 & 2008-09) - 43%
- Employer Contribution Holiday (2003-12) - 17%
- Multiplier Increase in 2001 - 19%
- Other - 21%
Investment Returns Account for Most Pension Fund Revenues Since 2001 & Employer Contributions for Little

Governor Corbett’s Pension Proposal

• Lower employer pension contributions for 5 years
• New employees enrolled in 401(k)-type plan
• Pensions cut for current employees: for future service
  – Multiplier falls from 2.5% of salary per year to 2%
  – Final salary averaged over last 5 years, not 3 years
  – Pensions capped at $113,500
  – “Option 4” cashing out made less generous
Impact of Governor’s Proposal on Taxpayers

• Closing the defined benefit plans will lower investment returns on plan assets
  – Composition of assets needs to shift to safer, lower-return funds
  – More assets need to be liquid

• Lower investment returns = higher taxpayer costs
Impact of Closing a DB Plan: Governor’s Pension Consultant

“Under a closed plan, as the active population shrinks and the retired population continues to grow...this could jeopardize the ability of...assets to earn the assumed valuation rate of return ....long-term, thereby putting upward pressure on costs towards the end of the projection period.”

-- Milliman, Study Reflecting the Impact of Closing the Florida Retirement System Defined Benefit Plan to New Members Effective January 1, 2014, February 15, 2013,
Impact of Closing a DB Plan: Commonwealth Foundation Expert

“The transition from a defined-benefit to a defined contribution regime presents its own set of challenges. Any existing unfunded liability in the former will need to be paid off, and usually more quickly than it would have had to be if the plan were retained. Such shortening can influence the Sponsor...to revise the assumed interest rate downward, especially if it is overly optimistic. The impact will be to raise the size of the sponsor’s contribution to compensate for the smaller contribution resulting from the slower expected appreciation of assets.”

-- Richard Dreyfuss, Fixing the Public Sector Pension Problem: the True Path to Long-Term Reform, Manhattan Institute Civic Report No. 74, February 2013
Impact of Closing a DB Plan: Studies in a Dozen Other States

• Actuarial consensus that investment returns fall and taxpayer costs rise

• See Appendix to KRC Pension Primer #1 for annotated bibliography of studies on Arizona, California, Colorado, Kansas, Kentucky, Minnesota, Nevada, New Hampshire, New Mexico, New York, Texas, and Wisconsin
Impact of Closing a DB Plan: Actual Experience in Three States

• *Michigan*: Unfunded liabilities since closing DB plan in 1997 up from $697 million to $4.078 billion

• *Alaska*: Unfunded liabilities up from $3.8 billion in 2006 to $7 billion in 2011

• *West Virginia* reopened its defined benefit plan in 2005
Impact on Taxpayers 2: Short-Sighted Cuts in State Contributions

Governor’s Keystone Pension Report

• One of the “primary drivers of the current pension crisis” was “nearly a decade of underfunding by state government and local school districts”
• “Act 40 [of 2003] resulted in the state’s underfunding of both SERS and PSERS by more than $5.9 billion.”
• “Act 40’s underfunding of the pension systems had the effect of freeing up General Fund dollars that then became available to spend elsewhere. And spent they were.”
• This led to a “‘robbing Peter to pay Paul’ budget.”
• “This same dynamic often repeated itself at a school district level... Lower state contributions meant lower district contributions... freeing up dollars in local district budgets that could be and were spent elsewhere...The result was...an underfunding of pension systems while...exacerbating future obligations.”
Corbett Proposal Has More Short-Sighted Cuts

• As Ronald Reagan might say “There You Go Again”

• Overall: Treasure McCord Estimates the Governor’s plan will increase Pennsylvania’s pension debt by 25 billion by 2046
Collar Adjustment Only

SERS+PSERS: Unfunded Liability
(Amounts in Millions)

Adjustment to collars needed as hill too steep to climb
Increases UAL, exacerbating PA’s long-term problem
Proverbial kicking the can down the road

Baseline Expectations
Adjustment to the Rate Collars
Other Impacts on Taxpayers

- Retirement costs for new employees: 3% to 4%
- Cost increase fully phased in: $179 million per year, $112 million to school districts
- Administrative costs of two pension plans
- Risk of court rejection of pension cuts for current employees—increasing pension debt
- Shift to less cost-effective DC plans
- Higher employee turnover
Impacts on Employees and Employers

• Lower quality retirement plans—which no longer compensate adequately for average salaries below the private sector

• Loss of defined benefit plans as a cost-effective tool for retaining experience employees
Keeping Pensions in Perspective

• Tax revenues lost to corporate tax cuts and unaccountable tax credits > $1 billion annually

• Over 30 years, pension debt is modest as a share of the total state budget

• Pension debt is small relative to the “inequality tax”—$40 billion more goes each year to PA’s “1%” because of higher inequity
What Are the Solutions?

• Give Pension Reform Act of 2010 time to work
• Implement lessons from well-funded plans: make the required contributions
• PA needs revenue—to invest in the future, pay for essential services, & meet pension promise
• PA should emulate California in helping private businesses invest in efficient pooled pensions
• Focus on the real retirement crisis—the lack of good private pensions
Thank You!

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Upcoming Webinars

Making Medicaid Expansion a Reality in Pennsylvania
Tuesday May 14, 2013 4-5 p.m.

Did They or Didn’t They? Education Funding Cuts in Pennsylvania
Tuesday, May 28, 2013 4-5 p.m.

Learn more and register: http://pennbpc.org/webinars.