Estimates of Pension Costs are Just a Guess

The Public Employee Retirement Commission (PERC) recently-released reports evaluating pension reform bills note that actuaries disagree on the cost or savings of certain reforms. This disagreement isn't a problem with reform—it is a problem with the current system. Here is what lawmakers should know about projections of pension costs:

1) The actual costs of defined benefit plans are **unknown**. Actuaries estimate these costs, but when they err—such as the unrealistic rates of return established by PSERS and SERS—additional costs are transferred onto taxpayers. In contrast to the rosy assumptions surrounding defined benefit plans, defined contribution plans have costs which are **fixed by law and known**. Comparisons are problematic, as actuaries are comparing actual costs of a defined contribution plan with their estimated costs for a defined benefit plan.

2) Reports comparing costs are often held hostage by faulty assumptions. SERS' and PSERS' estimates of future costs assume the current public plans will return **7.5% on investments every year** going forward, and that future politicians will keep fully funding these plans. **But both assumptions have already proven false**, which is why we currently have a $47 billion unfunded liability.

3) Defined contribution plans require a pay-as-you-go approach that take the politics out of pensions and prevent manipulation of pension benefits and payments that created the crisis. Defined contribution plans have **no unfunded liability**.

4) Under Act 120—assuming both 7.5% investment return and that lawmakers continue to make payments as scheduled—**taxpayers will pay $212.4 billion** over the next 30 years toward SERS and PSERS costs.[1] More has to be done to protect Pennsylvania's families.

5) Claims by PSERS and SERS that moving new employees out of the pension system adds costs are grossly overstated. Effectively, the argument is that to have enough "cash flow" to pay retirees, funds will have to move from long-term investments to short-term accounts that have lower risk and lower return.

   But as Pew Charitable Trusts Senior Researcher David Draine explained to the House State Government Committee, SERS and PSERS claim they'll have to move investments at a point when pension funds will have exactly the same cash flow as today:

   > "The actuary for the State Employees' plan suggests that in 2024 the pension plan should start moving its investments into safer assets. For 2013, actuarial projections for the state employees plan estimate that benefit payments will equal 11.3 percent of plan assets. That same projection estimates that for 2024, benefit payments will be equal to 11.6 percent of plan assets."

   The PERC reports also questions SERS and PSERS analysis of lower investment returns, noting that their analysis—which assumes a 7.5% rate of return currently, but lower rates of return under reform proposals—represent a singular estimate, when a range of projections would have been more useful.

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[1] SERS Supplemental Budget Information http://www.portal.state.pa.us/portal/server.pt/document/1324311/budgetbinder2013_pdf; PSERS **Current Employer Contribution Rate and 30-Year Rate Projections** http://www.psers.state.pa.us/content/pfr/resources/contributions.pdf