An Old Vinegar in a New Bottle: 5 Reasons Lawmakers Should Reject 3-Way Hybrid Pension

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Pennsylvania legislative leaders are considering trying to shoe-horn into the end of the legislative session a pension proposal that is an amalgam of old proposals rejected in the past four years. Based on actuarial studies, Keystone Research Center urges lawmakers not to take up the so-called 3-way hybrid because it would not generate meaningful savings for the state but would deeply cut retirement benefits for future employees.

Under the 3-way hybrid, new employees would choose among three retirement options: one similar to Gov. Corbett's 2013 proposal to switch new employees fully to 401(k)-style retirement savings accounts; another similar to the "side-by-side hybrid" rejected by the state House at the end of 2015 (that would provide a defined benefit half that for current [Act 120] employees plus a defined contribution [DC] savings account); and a third that would give employees a larger defined benefit multiplier than the side-by-side (1.25 instead of 1) along with a DC savings account.

Here are five reasons Pennsylvania should not adopt this plan:

1. The 3-way hybrid does not generate meaningful taxpayer savings. Employer (taxpayer) contributions to public pensions for the next 30+ years change little with the hybrid compared to Act 120, as shown by a chart in the PSERS actuarial study. School districts get no relief at all in the first dozen years, paying more for pensions over this period than under Act 120.

2. The hybrid plan cuts retirement benefits by about a third on average for typical employees and more than 50 percent for some. Some career teachers would have to work an extra decade to retire on full pension (e.g., at 67 instead of 57), making teaching a less appealing career and driving up average salaries for districts as teachers work longer to avoid a deeper pension cut.

3. The cuts in retirement benefits would make overall compensation for Pennsylvania state and school employees uncompetitive for those with a college degree or more, such as teachers. An August study finds that teacher pay in Pennsylvania already trails private sector pay for comparably educated employees by 10-15 percent.

4. The 3-way hybrid would **increase** taxpayer long-run compensation costs for public employees. The state and school districts will need to increase future salaries to offset pension cuts. Average salaries will likely rise as more career employees work to 67. By cutting the funds flow for young employees into existing pensions, the PSERS actuarial study notes, the hybrid could also lower investment returns on pension assets, requiring more taxpayer contributions.

5. Slashing retirement benefits deeply would exacerbate PA's looming teacher shortage and make it hard to attract and retain the great teachers at the heart of great schools.

Some lawmakers favor 401(k)-style accounts to reduce taxpayer financial market risk; but shifting to DC accounts guarantees higher future costs, because individual accounts have lower investment returns and higher fees than DB pensions. No matter how many times you ask the actuaries, the answer will be the same: moving future employees to inefficient DC accounts cuts benefits but does not generate savings. Instead, lawmakers should reduce taxpayer risk within an efficient DB framework, as they did under Act 120.