The Keystone Research Center
412 North Third Street
Harrisburg PA 17101
www.keystoneresearch.org

TALKING POINTS – GOVERNOR CORBETT'S PROPOSAL TO REPLACE PENSIONS WITH 401(K)-TYPE SAVINGS ACCOUNTS

Some Pennsylvania lawmakers reportedly favor dusting off Governor Corbett's 2013 proposal to eliminate guaranteed pensions for new state and school employees, establishing 401(k)-type savings accounts for each employee. In light of this, it is important to remember the evidence from pension actuaries, other research, and other states that led lawmakers to reject a switch to 401(k)-type savings in 2013. Replacing current pensions with 401(k) type savings would:

- ***Do nothing to alleviate the current budget crisis*.**

- ***Dig a deeper pension hole*** long term. Actuaries for Pennsylvania's pension systems estimated that closing the existing pension plans to new employees would increase pension debt by about $40 billion.[i] Studies in a dozen other states and experience in three states also point to a high transition cost from closing the existing pension plans to future teachers, nurses, and other public servants.

- ***Increase the cost of retirement benefits for future school employees**.* For new employees in Pennsylvania's school employee retirement plan, a switch to 401(k)-type savings would increase the cost of benefits even for new employees, and would save no money for school and state employees taken together.[ii]

- ***Cut retirement benefits by a third to a half***. Defined contribution (401(k)-type) savings accounts have high administrative and financial fees. They also deliver lower investment returns (since employees not professionals make investment choices). Studies indicate that employees would see benefit cuts of a third to nearly half (with the same total contributions from employees plus employers).[iii] Reduced benefits could also impose costs on employers and taxpayers, who would have to increase retirement contributions and/or wages to retain high-quality employees.

- ***Undercut the quality of public schools and services***. Cutting retirement benefits and eliminating the incentive to work in public service for a career will lead more of the best mid-career teachers and mission-driven state workers to leave for higher-paid private jobs.

Summing up, neither the Corbett 401(k) plan nor the Corbett/Tobash proposal represent forward movement on pensions. Neither saves money now, both slash pension benefits for new employees, and both risk a large transition cost.

Keystone Research Center, Senate Democrats, and Rep. Glen Grell have offered better ways to build on Act 120 (of 2010) that are fair to taxpayers and retirees. Part of the solution should be asking corporations to pay their fair share of taxes, bringing in revenue to fund education, other essential services, and pensions.

---

[i] A letter from Cheiron, the consulting actuary for the Public Employee Retirement Commission (PERC) to PERC, summarizes the transition costs of the Senate version (SB 922) of the Governor's 401(k)-type proposal based on the actuarial studies by the PSERS and SERS actuaries. Tables 5 and Table 6 of the letter show transition costs of $35 billion for PSERS and $7.2 billion for SERS, for a total of $42.2 billion (on a cash flow basis – i.e., in nominal dollars). See "Letter from Tony Parisi to James L. McAneny, Executive Director, Public Employee Retirement Commission, Re: Senate Bill No. 922 (Printer's No. 1252, as Amended by AO2498)," in Public Employee Retirement Commission, *Actuarial Note Transmittal, Senate Bill Number 922, Printer's Number 1252, as amended by Amendment Number 02498*, online at https://rlws.sers.pa.gov/apex/f?p=146:15:1837450920335::::P15_HIST_LEG_KEY:2726, pp. 21-35. (Warning: the complete PERC Actuarial Note Transmittal in which the Cheiron letter can be found is 583 pages.) See also Stephen Herzenberg, *A $40 Billion Dollar Oversight: Actuarial Studies Document High Cost of Governor's Pension Plan*, Keystone Research Center; online at http://keystoneresearch.org/publications/research/pension-primer-7-40-billion-dollar-oversight. This KRC brief was written based on actuarial studies of the House version of the Governor's 401(k) proposal, which also included unconstitutional cuts in benefits for current members. Nonetheless, the findings on the transition cost estimates are essentially the same as those summarized by Cheiron based on the actuarial studies of the Senate version of the Governor's proposal, without unconstitutional benefit cuts.

[ii] Stephen Herzenberg, *Paying More for Less: Cost of New Employee Pensions Will Rise with Defined Contribution Plan, Undoing 2010 Savings for Taxpayers*, Keystone Research Center; online at http://keystoneresearch.org/publications/research/pension-primer-2-paying-more-less. Since the publication of this brief the estimated long-term (normal) cost of new employee pensions for public school employees has increased to 3.25%. This is still less than 4%, so the employer (taxpayer) cost of school employee retirement would exceed that under Act 120 if Pennsylvania switched to 401(k)-type defined contribution accounts with a 4% employer contribution. Across SERS and PSERS, current estimates indicate that the normal cost of pensions for new employees under Act 120 is now slightly under 4%; this is similar to the cost of 401(k)-type savings requiring a 4% employer contribution.

[iii] Stephen Herzenberg, *Less Bang for Pennsylvania's Buck: Governor's Pension Proposal Would Force Taxpayers (and Employees) to Foot the Bill for Retirement Plans with High Fees, Low Returns*, Keystone Research Center; online at http://keystoneresearch.org/publications/research/pension-primer-6-less-bang-PA-buck