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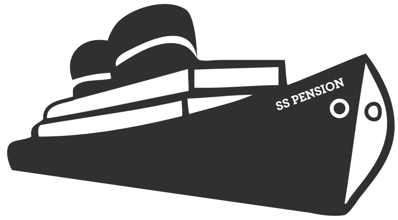

5 Pension Myths vs. Facts

Myth #1

Act 120 of 2010 solved the problem of growing debt for teacher and state worker pensions.

FACT: The Pennsylvania State Education Association, for example, claims Act 120 **fixed our pension crisis** by lowering upcoming pension costs.[1] But there are problems with this claim: First, it ignores a **dramatically underfunded system**. We're already over $40 billion in debt, which will require higher taxes to pay off.

Second, the claim assumes that we'll get phenomenal returns on the stock market. But when pension fund officials lowered the expected rate of return from 8% to a still improbable 7.5% for public school and state employee pension systems, that simple adjustment added another **$5.5 billion to Pennsylvania's pension shortfall**.[2] Finally, Act 120 pushes costs into future years, burdening taxpayers and our children, just as previous laws delayed funding of our pension systems.

Myth #2

Defined benefit pension plans are better for taxpayers than defined contribution plans.

FACT: A defined benefit plan guarantees a worker a set level of yearly income after he or she retires. That income comes from employee contributions and investment returns, with the remainder covered by taxpayers—the "employer" for public school and state workers. If the first two fall short, then taxpayers have to foot the bill, which is now rising fast for Pennsylvania.

Defined benefit plans **encourage lawmakers to play politics with workers' pensions**, increasing benefits for current worker in good times (regardless of whether the benefits are affordable in the long run) and pushing costs off to future taxpayers in bad times.[3] By contrast, defined contribution plans—which require a set contribution from employers and employees every month—make pension benefits predictable for taxpayers *and* workers.

Myth #3

Defined contribution, or 401(k) plans, don't provide for an adequate retirement.

FACT: Depending on plan design, 401(k) plans can be very generous, just as some pension plans are more generous for retirees than others. 401(k)s can provide a substantial replacement income at retirement when workers invest their entire careers. Evidence showing lower 401(k) income is based largely on workers who participated for only part of their careers.[4]

Workers also gain more control with an individual 401(k) plan than with a single, collective pension fund the state manages and to which everyone contributes. As a worker, you own your 401(k) plan, which is portable when moving jobs, and you can pass the assets down to your children or heirs. Best of all, you know exactly how much goes in and out—no politician can raid your retirement or underfund it.

1 The Pennsylvania State Education Association, "Keep the Promise: 5 Facts You Can Tell Your Neighbor About Your Pension," http://www.psea.org/uploadedFiles/LegislationAndPolitics/Pension_Issues/Pension-5FactsToTellYourNeighbors.pdf.

2 Public School Employees' Retirement System of Pennsylvania, "Actuarial Valuation 2011," June 30, 2011, http://www.psers.state.pa.us/content/publications/actuarialvaluations/PSERS%202011%20Val%20Actuary's%20Report%20(Final).pdf; Eric Boehm, "PA Public Pension Fund Lowers Expectations," *Pennsylvania Independent*, May 3, 2012, http://paindependent.com/2012/05/pa-public-pension-fund-lowers- expectations/.

3 Donald Gilliland, "Corbett's Coming Pension Fight: Altering Benefits for Current Teachers and State Employees," The Patriot-News, January 18, 2013, http://www.pennlive.com/midstate/index.ssf/2013/01/corbett_to_make_pension_reform.html.

4 Sarah Holden *et al.*, "Can 401(k) Accumulations Generate Significant Income for Future Retirees?", *Employee Benefits Research Institute*, November 2002, http://www.commonwealthfoundation.org/docLib/20091215_401(k)Accumulations.pdf.

Myth #4

State-owned pension plans cost less to administer and invest than 401(k) plans managed by Wall Street firms.

FACT: With officials having promised too much and paid too little, Pennyslvania's troubled state pension funds are now relying on expensive Wall Street investment firms to close looming deficits. In 2006, The State Employees' Retirement System (SERS) spent **$3 billion on six private investment firms** to buy risky hedge funds, in hopes of earning lavish returns to cover its pension shortfall.[5]

A Deloitte study found that 401(k) plans cost the same or less than traditional plans to administer. The median "all-in" fees—which cover all the financial costs and interest of an investment—were 0.72% of assets, and administrative costs for larger 401(k) plans were smaller.[6] The administrative costs and investment fees of SERS and the Public School Employees' Retirement System (PSERS) were **0.91%** and **1.10%** last year, respectively.[7]

Myth #5

Gov. Tom Corbett and lawmakers will take away my hard-earned pension with their proposals.

FACT: Gov. Corbett's proposed pension reform plan will not make any changes to the pension benefits you've already earned, nor would it touch those of retirees. **The Pennsylvania Constitution guarantees both**.[8] The main reform would be to put all newly hired workers into a transparent 401(k)-style plan, which states such as Michigan and Alaska adopted as their pension systems became unsustainable. Other reforms lawmakers may negotiate include **changing the unearned future benefits of current workers**, and **adjusting the final pay used to calculate a worker's pension**.[9]

These reforms may sound drastic, but the reason is simple: Pension costs are ballooning so quickly, they threaten to gobble up funds for education, public safety and welfare spending. Without changes, school districts will likely pay pension obligations by laying off more teachers and cutting programs. By adopting real, comprehensive pension reforms now, Pennsylvania can save our jobs, schools and cities.

Genuine Pension Reform: 5 Solutions

Public retirement plans should be **affordable** for taxpayers, have **predictable** costs for state and local governments, and be paid while workers are **currently working** and not by future generations. We should:

1. Establish a new defined contribution plan like a 401(k) plan for new state and local government workers, school employees, judges, and legislators.
2. Prohibit new borrowing to finance pensions for all public pension systems (as already done for statewide plans). Borrowing only increases debt and taxpayer risk.
3. Don't allow accounting gimmicks that make pension liabilities look smaller or permit delays in paying for workers' pensions.
4. Consider modifying unearned benefits and eliminate loopholes that allow people to game the pension system, to prevent rising pension costs forcing cuts in education, public safety or other essential programs.
5. Fully fund existing pensions without increasing taxes.

5 Joseph N. DiStefano, "PhillyDeals: State Pension Board Made Expensive Bets on Hedge Funds," Philadelphia Inquirer, January 28, 2013, http://www.philly.com/philly/business/columnists/20130127_PhillyDeals__State_pension_board_made_expensive_bet_on_hedge_funds.html
6 Deloitte, "Defined Contribution/401(k) Fee Study," Spring 2009, http://www.commonwealthfoundation.org/docLib/20091215_DCAdministrativeCostStudy.pdf.
7 State Employees' Retirement System, "Comprehensive Annual Financial Report," 2011, http://www.portal.state.pa.us/portal/server.pt?open=514&objID=701628&mode=2; Public School Employees' Retirement System, "Comprehensive Annual Financial Report," June 30, 2012, http://www.psers.state.pa.us/publications/general/cafr.htm.
8 Constitution of the Commonwealth of Pennsylvania, art. 1, sec. 17, http://sites.state.pa.us/PA_Constitution.html.
9 Charles Zogby, "Pennsylvania Pension System Reform," February 5, 2013, http://www.portal.state.pa.us/portal/server.pt/community/office_of_the_budget____home/4408.