POLICY MEMO
FROM THE COMMONWEALTH FOUNDATION

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Pennsylvania's Pension Systems: Reforms, Remaining Challenges, & Solutions

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Pension Reform Act 5 Overview

- Act 5 of 2017 reformed Pennsylvania's pension systems by moving new employees from a defined-benefit plan to a hybrid defined-benefit and defined-contribution plan. This was a meaningful step away from defined-benefit plans, in which politics dictate benefits and taxpayers bear all the risk.
  - January 1, 2019 – Most state employees hired on or after this date, including newly elected legislators, will have 45 days to choose between two hybrid plans or a straight defined-contribution plan.
  - July 1, 2019 – All public-school employees will have 90 days to choose between the three plans.
  - Current employees and legislators can opt into these plans within 90 days.

ACT 5 PENSION PLAN OPTIONS

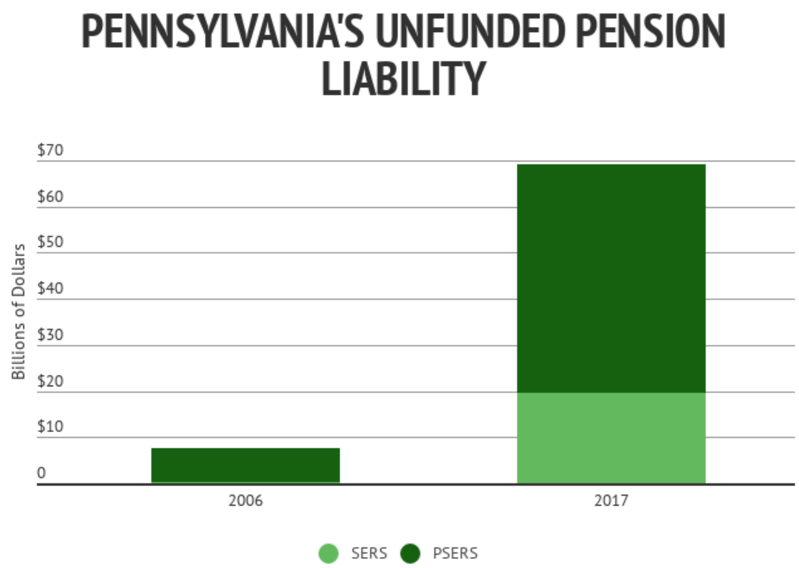
Plan	DC/DB Hybrid Plan with 1% Accrual Rate	DC/DB Hybrid Plan with 1.25% Accrual Rate	Full DC-only Plan
Employee Contribution (DB Side)	4.5% for PSERS; 4% for SERS	5.5% for PSERS; 5.0% for SERS	N/A
Vesting (DB Side)	10 years	10 years	N/A
Employee Contribution (DC Side)	3% for PSERS; 3.5% for SERS	2.75% for PSERS; 3.25% for SERS	7.5% for PSERS and SERS
Employer Contribution (DC Side)	2% for PSERS; 2% for SERS	2.25% for PSERS; 2.25% for SERS	2% for PSERS; 3.5% for SERS
Vesting (DC Side)	After completion of 3 years of service	After completion of 3 years of service	3 year vesting for employer contributions
Final Average Salary Determination	Last 5 years	Last 5 years	N/A
Superannuation Age	67 with 3 years of service	67 with 3 years of service or Rule 97*	N/A

*Rule 97: Sum of a participant's age and service must be equal to or greater than 97 to receive benefits.

- Other notable changes include:
    - Shared risk and shared gain provisions, which increase employee contributions if investments underperform and reduce contributions if investments outperform.
    - A cap on voluntary overtime as a component of final salary.
    - Employees may make contributions above the minimum required by Act 5.

Remaining Challenges

- Pennsylvania's total unfunded liability stands at nearly $70 billion and growing.
    - Public School Employees' Retirement System's liability totaled $49.4 billion in December 2017.
    - State Employees' Retirement System's liability totaled $19.7 billion in June 2017.



Source: PSERS and SERS 2017 Comprehensive Annual Financial Reports

- Municipal pension plans also face unfunded liabilities. According to the Pennsylvania Municipal League, 66 of 67 counties have a severely underfunded pension plan. Total unfunded liabilities approached $8 billion in 2015, up from $1 billion in 2013.

The Way Forward

- Creating a defined-contribution plan for all new employees would slow the accumulation of new debt and create a sustainable system with additional flexibility for state workers.
- Lawmakers can tackle the unfunded liability in several ways:
    - Increase pension contributions to pay off the unfunded liability over a 20-year period, as required in House Bill 778.
    - Modify pension plan benefits not yet earned.
    - Limit state spending growth and use revenue options—such as privatizing Pennsylvania's liquor control system—to pay down the state's unfunded liability.
- Enacting municipal pension reforms, supported by a bi-partisan coalition of mayors, to increase transparency, and moving to cash balance or defined-contribution plans for new employees in distressed municipalities.