

PSPRS Pension Funding Problem FAQs

What is the problem?

The PSPRS system has over \$11 billion of legacy debt to repay, but underlying assumptions that set the required contribution rates haven't been met. This means that although employers have made their required contributions, they haven't been enough to actually start repaying this debt. If this continues, the debt won't ever be repaid, burdening future taxpayers with an even larger problem.

How did we get here?

There are a number of reasons the plans have accumulated over \$11 billion in legacy debt. The primary drivers of that debt were:

- In 1986, the Legislature instituted a permanent benefit increase (PBI) formula that created huge structural issues for the system. The PBI gave 4% benefit increases every year from 1986-2016. So even when the plan was losing assets during the Great Recession, statutory benefit increases were given.
- The courts overturned most of the Legislature's first attempt to reform the plans in the early 2010s, causing back payments and the further accumulation of debt.
- PSPRS investments were poor, and assets were significantly reduced by two recessions.
- Previous PSPRS Boards adopted one-size fits all assumptions that have led to insufficient employer contributions.

I thought the Legislature reformed PSPRS, why does the cost keep going up?

The Legislature created separate, more sustainably funded, plans moving forward for new PSPRS, CORP and EORP members. However, the courts have ruled that existing employee and retirement benefits can't be diminished, so the legacy debt from those plans still has to be repaid. The annual costs keep increasing because the repayment plan adopted by the PSPRS Board doesn't actually require sufficient contributions towards the debt each year, so the debt keeps increasing, driving costs up.

Why can't we reduce benefits to deal with this?

The Legislature tried to do just that, and the courts overturned each change. The court decisions cited both the Arizona and U.S. Constitutions in protecting contractual public pension obligations. This also applied to any increase in existing member contribution rates that were outlined in statute.

If these problems were caused by the PSPRS Board, why continue to let them manage these systems?

Many of these underlying issues were adopted by previous PSPRS boards. Prior boards were almost exclusively made up of representatives of plan members, rather than employers; the entities responsible for paying the bill. In 2017, the legislature overhauled the PSPRS Board's governance structure. There are now nine members with four appointed by member groups, four appointed by employer groups and one nominated by the remainder of the board and appointed by the Governor.

The new members of the Board of Trustees are relatively new, with the first appointed in 2017. The board has expressed a commitment towards greater transparency and communication, but it will be important to continue to provide direct feedback to the trustees on ways they can continue to improve.

Why haven't required contributions been enough?

The payment schedule for repaying the existing \$11 billion in debt requires that payments grow each year by 3.5% (payments are made as a percent of total payroll). Since most employers in PSPRS are well established, they aren't expanding their payroll each year by 3.5%, which means that the contribution rate isn't increasing fast enough to cover

the dollar amount required to make the debt payment. So, the rate set by the Board of Trustees and paid by employers is insufficient to fund the plan.

Why hasn't this already been addressed?

There were a number of other issues with the PSPRS system that were masking a scrutiny of the underlying plan assumptions. Now that those other issues have been addressed and the system has hired a new actuary, they are evaluating the underlying plan assumptions for repaying the existing debt. This is what alerted employer groups to the significant challenge now facing them.

What is the solution to this problem?

More resources need to be contributed to make the necessary payments to eliminate each plan's existing debt. The PSPRS board is dedicated to making changes to the actuarial assumptions that will cause the required contributions to be set high enough to meet that level. However, employers in PSPRS and CORP can make additional contributions without waiting for changes from the PSPRS Board to repay their existing debt if they have the revenue and expenditure capacity to do so.

Why is putting more resources in now the cheapest option?

Since current payments are based on actuarial assumptions that are not being met, those payments aren't high enough to keep up with the debt repayment schedule, causing more debt to be accumulated. Making sufficient payments will prevent additional debt from accruing as a result of missing these assumptions. This means that instead of accruing debt each year, employers will make payments that will go towards decreasing their debt.

Additionally, regardless of actuarial assumptions, contributing more money into PSPRS now allows time for those contributions to be invested. This leads to more of the debt being repaid with investment earnings rather than future employer contributions.

Why should this problem be prioritized over other investments?

The PSPRS board is going to phase-in the necessary changes to require employers to contribute more in the next few years. Any additional contributions made now will reduce the impact that those changes have on the ongoing cost to the county.

Absent changes to contributions now, future taxpayers will have to bear an even greater burden, which will crowd out more investments in the community.

Why should this problem be paid for now, versus the current plan which is scheduled to pay more later?

The legacy debt that needs to be repaid is from current and past employee retirement benefits. These employees are providing services to today's taxpayers, if we continue down this path the burden of repaying this debt will be shifted to future taxpayers who did not receive any services for the cost they will be bearing.

Additionally, contributing more money earlier allows more time for investment earnings to grow, reducing the amount of contributions necessary to repay the debt.

How can we be confident that PSPRS will make money in the long-run?

Even during and after the Great Recession, the plan was able to earn an average of about 6% annually. While this was underperforming their targeted return, the investments that counties can make do not typically see those types of returns. For example, the State Treasurer's Local Government Investment Pool (LGIP) yield over the last three years has been between 0.5% and 3%.