SB 1365 Threatens Higher Taxpayer Costs & Pension Risks

PSPRS Tier 3 Reform is Working

- Arizona Public Safety Personnel Retirement System (PSPRS) Tier 3 arose from a bipartisan, stakeholder-negotiated pension reform in 2016, after a rapid freefall saw PSPRS decline from 120% funded in 2001 to nearly 40% funded by 2016.
- Tier 3 included a risk-managed pension design with a **50/50 contribution rate split** between employers and employees, consistent with many other state pension systems, including the Arizona State Retirement System, Washington State's public safety pension, and Michigan's teacher pension.
- 50/50 cost sharing is **foundational to Tier 3 risk management** and a key reason that employers have felt confident enough in PSPRS' trajectory that they have made $5 billion in supplemental contributions since 2019, improving PSPRS to nearly 70% funded today.

50/50 cost sharing is core to the Tier 3 pension design, as it:

- ***is based in the logic of shared risk/shared reward;***
- ***mitigates forward looking financial risks, allowing employers to focus on paying down legacy pension debt responsibly.***

SB 1365 Would Break Tier 3's 50/50 Cost Sharing Mechanism and Risk Higher Taxpayer Costs

- SB 1365 would cap the contribution rate paid by Tier 3 employees at 9.5% and require employers to cover any needed remainder in the likely event of underperforming markets.
- Reason Foundation's actuarial modeling for PSPRS forecasts that **SB 1365 could result in taxpayers being required to cover approximately $1 billion in unanticipated additional costs over the next 30 years**, assuming market conditions similar to those seen since 2000.
- Applying a cap on employee contributions would return to the types of design features that allowed PSPRS to get over $10 billion underfunded.

SB 1365 Unlikely to Affect Recruitment & Retention

- The push to cap employee contribution rates in PSPRS Tier 3 is rooted in the idea that it would help improve recruitment and retention, but states where pensions already have caps on employee contribution rates have also seen recruitment and retention challenges.
- Studies and actual employee turnover data show that pensions rank far down the list of employee priorities compared to others like salary, flexibility, work-life balance, job satisfaction, and upwards mobility.
- States that have expanded employee pension benefits under similar logic since the Great Recession have seen higher costs but no discernable change in recruitment and retention as a result.

Takeaway: With over $7 billion in unfunded liabilities remaining to tackle, it would be poor financial stewardship to fundamentally alter the design of a successful PSPRS reform only seven years into a multidecade turnaround project, especially given the weak influence pensions have on employee recruitment and retention.

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