# FY 2025-26 Employer Contribution Rate – Frequently Asked Questions

## What is the FY 2025-26 Employer Contribution Rate (ECR)?

On December 20, 2024, the Public School Employees' Retirement System (PSERS) Board of Trustees certified the FY 2025-26 ECR at 34.00%.

The ECR is the percentage of payroll that local school employers and the Commonwealth will share and pay toward retired and current school employees' benefits for the July 1, 2025-June 30, 2026, fiscal year. School boards set their budgets based on the ECR, and the Commonwealth's share is included in the Pennsylvania Department of Education's budget.

The 34.00% ECR represents the first rate increase in two fiscal years. The ECR fell slightly in FY 2023-24 and again in the current FY 2024-25.

- The FY 2026 ECR is 0.10% higher than the FY 2025 rate of 33.90%.
- Total FY 2026 employer contributions are projected to rise by about 4% ($210 million) to $5.5 billion compared to the FY 2025 estimate of $5.29 billion.

## Why did the FY 2026 ECR increase when PSERS surpassed its 7.00% assumed net investment rate of return in FY 2024?

The Public School Employees' Retirement Code mandates PSERS Board to adopt an employer contribution rate that is calculated in accordance with statutory formula and certified by the actuary. The board's actuarial consultant is Gallagher.

The ECR is made up of several actuarial components, not just net investment returns. Other ECR components include school employer payroll, retirement and termination projections, and demographic factors such as mortality.

The FY 2026 ECR change is the net result of actuarial losses and gains PSERS experienced in FY 2024 (July 1, 2023 – June 30, 2024). Gallagher's report showed:

- The FY 2024 losses were caused by slightly unfavorable demographic changes related to salaries, mortality, and retirements. Those changes were partially offset by gains associated with higher-than-expected total employer payroll growth.
- PSERS' active membership increased by about 1.6% to 255,652, and total annuitant membership increased by about 1.7% to 253,896.
- PSERS' actuarial funded status rose from 63.6% in FY 2023 to 64.8% in FY 2024, which is the highest funded status in over a decade.
- PSERS' unfunded actuarial liability decreased by $358 million to about $42 billion in FY2024. This decrease was caused by the Commonwealth and school employers providing the full FY 2024 actuarially determined contribution.
    - FY 2024 marked the eighth consecutive year PSERS received full actuarially determined contributions from the Commonwealth and school employers.
    - More than 80% of the full payments are used to pay down the system's pension debt, which was caused by prior suppressed employer contributions, unfunded benefit enhancements and market downturns.

**How are actuarial losses and gains calculated?**

ECR components are amortized over 24 years per Act 120 of 2010. The law also requires PSERS' net investment gains and losses to undergo another actuarial method known as "smoothing."

Smoothing means annual investment gains and losses gradually are factored into the total pension liability in 1/10th increments per year for a decade. Smoothing helps to stabilize the budgeting process for school employers and the Commonwealth. Investment returns over 10-year periods are historically much less volatile than one-year returns.

By comparison, payroll and demographic changes do not have smoothing factors. All of their year-to-year changes are immediately factored into the total pension liability and impact the 24-year amortization of unfunded liability used to set next year's ECR.

**How does investment smoothing work in practice?**

Page 13 of PSERS June 30, 2024, Valuation presentation (pictured below) shows how total net investment gains/losses are smoothed. For instance, the "recognized" box shows the FY 2014-2015 loss has finished its smoothing cycle while the FY 24 gain is in its first smoothing year. By adding and subtracting a decade of smoothed values, the actuary calculated a total investment loss of $587 million for the FY 2024 valuation.

# Actuarial Value of Assets

## Ten-year asset smoothing method

1. Market value of assets June 30, 2024 — $ 76.629 Bil
2. Determination of deferred gain (loss)

| Fiscal Year | Gain (Loss) | Recognized Amount – FY23/24 | Percent Deferred | Deferred Amount |
|---|---|---|---|---|
| 2023/2024 | $ 0.516 Bil | $ 0.051 Bil | 90.00 % | $ 0.464 Bil |
| 2022/2023 | (2.160) | (0.216) | 80.00 | (1.728) |
| 2021/2022 | (4.985) | (0.499) | 70.00 | (3.490) |
| 2020/2021 | 10.116 | 1.012 | 60.00 | 6.070 |
| 2019/2020 | (3.440) | (0.344) | 50.00 | (1.720) |
| 2018/2019 | (0.600) | (0.060) | 40.00 | (0.240) |
| 2017/2018 | 0.551 | 0.055 | 30.00 | 0.165 |
| 2016/2017 | 0.847 | 0.085 | 20.00 | 0.169 |
| 2015/2016 | (3.794) | (0.379) | 10.00 | (0.379) |
| 2014/2015 | (2.918) | (0.292) | 0.00 | 0.000 |
| | $ (5.867) Bil | $ (0.587) Bil | | $ (0.689) Bil |

3. Preliminary actuarial value of assets June 30, 2024: (1) – (2) — $ 77.318 Bil
4. 70% of the market value of assets June 30, 2024: (1) x 70% — $ 53.640 Bil
5. 130% of the market value of assets June 30, 2024: (1) x 130% — $ 99.618 Bil
6. Actuarial value of assets June 30, 2024: (3) not less than (4) and not greater than (5) — $ 77.318 Bil

Gallagher then factored the smoothed investment gains/losses into the financial impacts of the other ECR components to calculate the total net actuarial experience of -$833 million for FY 2024 (as shown in the image below).

## 2024 Net Actuarial Loss

| | | |
|---|---|---|
| 1. Investment return loss[1] | $ | 587 Mil |
| 2. Accrued liability experience (gains) and losses | | |
| - New entrants, pickups, and rehires | | 323 |
| - Individual salary increases | | 148 |
| - Mortality | | 164 |
| - Retirement/disability/terminations | | 46 |
| - Miscellaneous | | (158) |
| - Total | $ | 523 Mil |
| 3. Actual contributions greater than expected | $ | (277) Mil |
| 4. Net actuarial experience loss[2]: (1) + (2) + (3) | $ | 833 Mil |

1. 6.20% actual rate of return on the Actuarial Value of Assets vs. the assumed 7.00% rate of return.
2. Experience (gains) reduce the Retirement System's unfunded accrued liability and experience losses increase the Retirement System's unfunded accrued liability.

**What does this mean for the future?**

• ECR rates are projected to rise again slowly in future years. Future increases, however, are expected to remain lower than previous projections.

• The System's funded ratio is expected to continue rising as more workers who join the system do so under the reduced retirement benefit structures enacted by Act 120 of 2010 and Act 5 of 2017 and full annual funding continues to reduce the unfunded liability.

• Full annual funding since July 1, 2016, favorable long-term investment returns, and a declining cost of current benefits continue to make a positive difference on the financial health of PSERS.

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