Testimony

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Thank you, Chairman Eichelberger, Chairman Blake, and the Senate Finance Commitee for the opportunity to provide written testimony on the important issue of public employee pensions. AFSCME Council 13 Executive Director David Fillman could not attend today's hearing due to other previous commitments that he had.

For some Committee Members who don't understand who AFSCME COUNCIL 13 is, we are The American Federation of State, County and Municipal Employees (AFSCME) Council 13. AFSCME Council 13 represents over 65,000 members in Pennsylvania, of whom 45,000 are employees of the Commonwealth of Pennsylvania, and 20,000 members work for various Counties, Townships, Boroughs, Cities, Authorities, School Districts and non-profit employers.

A majority of our members are Commonwealth of Pennsylvania employees who participate in the State Employees Retirement System (SERS) but we also represent thousands of School District employees, who are members of the Pennsylvania School Employees Retirement System (PSERS). There have been a number of pension proposals that may affect all of our members and we are greatly concerned with some of the proposals under consideration.

I serve as a Governor appointed trustee to SERS. I have proudly done so since this appointment in the year 2000, and last year I was re-appointed by Governor Tom Corbett. In that position I monitor our investments and benefits for Commonwealth employees which are represented by over 20 different labor organizations. The system also covers management employees, the Governor, as well as the General Assembly, and the Judiciary in PA. I am also the Chairman of the Coalition of Labor Engagement and Accountable Revenues (CLEAR) Coalition. This is a group of 8 labor organizations representing over 1.1 million members, many of whom represent public employees who would be affected by any pension changes. I can assure you that no one is more committed to a well-run and properly funded retirement system than AFSCME and the other members of the CLEAR Coalition. For the vast majority of our members, their pension is their life savings. The pension system is also extremely important to the Commonwealth. It ensures that a substantial portion of the population can retire with dignity, it serves as a very effective recruitment and retention tool so that the public sector can employ a high quality workforce despite often paying below market wages, and pensions play an important role in Pennsylvania's economic development.

I think we should begin any discussion over possible changes to pension benefits with an understanding that the Courts of Pennsylvania have ruled that the State Constitution prohibits any reduction to the contractually owed defined benefit pension to all current members and annuitants of SERS as well as PSERS.

With the funding coming due for the benefit enhancements of 2001, members of the CLEAR Coalition started working with the legislature and then Governor Rendell beginning in 2010, to help relieve the long term funding issues that were approaching in 2012. That "2012 Spike" was actually being reduced considerably in the mid-2000's until the stock market collapse in 2008. Everyone's investments, not only in pensions but world-wide, took a nose dive. To add to that difficulty, the Commonwealth took a perfectly legal holiday on their contributions, which were justified by the fact that the returns on our investments in the good days pre-2008 were well into the double digits. For SERS, the Commonwealth paid very low contributions for years by taking advantage of the high rates of return. However, our members in SERS continued to pay their 6.25%, and PSERS members paid 7.5%, in good times and bad. In fact, we probably wouldn't be having this discussion if the returns were still as high as they were.

We should remember that over the long term, and despite the 2008 setback, our retirement systems' investments have actually outperformed assumed rates of return. So, although the 2008-2009 market crash has significantly affected the funding level of our plans, it is not the sole cause of the unfunded liabilities. It is indisputable that the Commonwealth has consistently deferred making required contributions, and continued to do so when we passed Act 120 over four years ago. Over the last ten years, employer contributions to SERS have been the smallest component of additions to the retirement system's assets. Employer contributions were set legislatively and did not fully meet the level set by the actuaries to keep the plans fully funded. For example, in the SERS plan, employer contributions totaled $2.0 billion from 2002 to 2011, representing 9% of total additions to plan net assets, compared to $3.3 billion or 16% of total additions attributed to employee contributions, and $15.4 billion, or 75%, of total additions attributed to investment earnings.

So the CLEAR Coalition, with the largest State and School District employee unions in harmony, worked with the legislature and supported Act 120 that was signed by Governor Rendell in November of 2010. For new employees of SERS, effective 1/1/11, and new employees of PSERS effective on 7/2/11

- Rolled back all of the benefit enhancements from 2001, yet new employees are paying the higher contribution rates (6.25 or 7.5%). This means new workers will have higher retirement ages, longer vesting periods, and accrue 20% less in benefits for each year of service.

- Offered an opportunity for new employees to get the post 2001 enhancements, AT THEIR COST raising their contribution rates to 9.3% and 10.3% for SERS & PSERS respectively.

- Eliminated "OPTION 4", the lump sum payouts.

- Created a sliding scale "shared risk" formula, that increases new employee contributions if investments do not meet expectations, but with the caveat that employers would not have contribution holidays as before.

Act 120 also addressed employer funding and puts the Commonwealth on a path to achieve fully funded pension plans in the future. Act 120 was very clearly a case of shared sacrifice by all stakeholders. Employees will pay more, for lower benefits, and the employers are committing to funding the pension plans on an actuarially sound basis. **We think Act 120 is an effective solution and should be given time to be fully implemented.**

You should also be aware that retirees did not escape sacrifice either. An important issue that sets Pennsylvania apart from most other states is the lack of a regular and recurring COLA (cost of living allowance) benefit for retirees. Although the vast majority of public employees in other states receive COLA increases annually, the Commonwealth of PA has saved almost $2 billion in pension costs by denying this benefit to our pensioners for over 13 years. A regular and recurring COLA typically adds 20% to 30% to the ongoing cost of the pension benefit.

Despite the passage of Act 120, there remains considerable concern with the cost of pensions in Pennsylvania. As I have already mentioned, much of this cost stems from the state's deferral of required contributions and recent investment loses. But the most important issue to keep in mind as you consider this issue is that the current unfunded obligations owed by the employers to the pension plan must be paid regardless of any changes made to the plans. In other words, the unfunded liabilities are for service already performed for which the employers did not adequately contribute. Basically, this is a debt that must be paid and the legislature would be unable to reduce that debt under existing interpretations of the State Constitution. Anything done now, will only affect the cost for future service performed by new employees.

In fact, moving to a defined contribution, 401k-type system would actually increase costs significantly. When the state of Nevada considered closing its defined benefit pension plan in favor of a defined contribution arrangement, actuaries determined that it would cost the state an additional 1.2 billion dollars in the first two years alone. This is because the plan must change its investment mix, accelerate its amortization of unfunded liabilities and incur substantial administrative costs in setting up and operating two different systems. We should expect the costs in Pennsylvania to substantially exceed that estimate in Nevada given the larger size and coverage of SERS and PSERS.

We also know that conversion to a 401k-type system would have negative consequences for employees. According to the National Institute on Retirement Security "Even after accounting for all the significant advantages of a DB retirement system over DC accounts, research shows that DB plans are more economically efficient then DC plans. DB pensions can deliver the same level of retirement benefits at nearly half the cost of a DC plan. Despite rhetoric to the contrary, a defined contribution plan is bad for both employees and taxpayers.

In this regard it's important to understand that the ongoing costs to the employers to pay for future pensions benefits accrued by employees is just 5.1% of pay for SERS and 8.1% for PSERS. The reason contributions are greater than that, and are scheduled to increase further, is because the state has deferred its past contributions. In essence, the state has borrowed from the pension plans and it must now pay that debt. As I have said previously, those payments must be made even if changes are made to future benefits. But it is unlikely that the legislature could design a reasonable retirement benefit that costs less than the current benefit. For these reasons, a change in benefits is not only unnecessary, it is counterproductive.

Keep in mind, SERS and PSERS pay out over $6.5 billion dollars in pension benefits each year to 300,000 annuitants. The average benefit from both systems is just $24,000 a year; in fact 70% of SERS annuitants receive benefits of less than $24,000. Because almost 90% of our pensioners live in the state, $6 billion in economic activity is generated as pensioners buy goods from local merchants, and pay local, school and state taxes.

Finally, all of us as public employees didn't come into public service seeking high wages, stock options, or golden parachutes. Many of our public jobs come with inherent physical demands, as well as physical hazards. Much more so than the private sector. OSHA laws don't cover PA public employees. Direct care nursing jobs are plagued with back and other injuries, often from clients that have "acted up". Correctional Officers and other Law Enforcement Officers protect us from the worst of the worst. Highway Workers have some the highest rates of occupational injuries and death. Unfortunately, 100 AFSCME PennDOT workers have lost their lives making the roads safer for the driving public.

We must also consider that a traditional DB pension plan has what no DC plan has...disability retirement. After subjecting Commonwealth employees to life threatening or debilitating injuries, the least we can do is provide them with a reasonable return for their sacrifices and provide a safety net in the event of injury. If the retirement benefit is converted to a defined contribution arrangement, the employers must be prepared to pay for the added and considerable cost of obtaining life and disability insurance for its workforce. Finally, we should consider that our current pension plan offers our employers flexibility. The Commonwealth has reduced its work force on numerous occasions by offering early retirement options. These savings help keep down the General Operating Budget; yet this would not be possible under a DC, hybrid, or cash balance plan.

While the level of pension expense is likely to grow in Pennsylvania, that cost must be put in context. During the 2002 to 2009 period, the employer contribution rate to SERS never once exceeded 5% of payroll. At this time the SERS Board is doing everything possible in asset allocation, and administration, to help raise investment revenues and reduce costs. The current system and benefit structure is effective. A change to a new system will not address our funding challenges, but will create a host of new problems and challenges in the years ahead.

Thank you for the opportunity to present this written testimony to the Committee.