Testimony of the Service Employees International Union Local 668

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Public hearing on proposals regarding the plan design of the public pensions

By
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Chairman Eichelberger, Minority Chairman Blake, and members of the State Senate Finance Committee, please accept this testimony on behalf of the Service Employees International Union Local 668.

SEIU Local 668 represents nearly 20,000 health and human services workers, including those who work as employment and youth counselors, social workers, corrections and probation officers, ChildLine and 911 operators, drug and alcohol counselors, and court employees, among others. Approximately half of our members are employed by the Commonwealth, and the remainder work for municipal, county, and private employers across the State. Our members are a diverse group of individuals, of varying ethnicities, political affiliations, and beliefs, but they are united by their dedication to serving your constituents – the people of Pennsylvania.

The members of SEIU Local 668 take the pension debt situation very seriously. The ongoing and prolonged debate of how to address the pension debt in the State Employees' Retirement System (SERS), [as well as the Pennsylvania School Employees' Retirement System (PSERS)] will affect the lives of thousands of SEIU Local 668 members and their ability to retire with security after a lifetime of serving the public.

We are especially concerned about proposals to change the design of public pensions, given the significant implications and consequences for our members, and retirement security in Pennsylvania as a whole. Moreover, we are troubled by the direction of discussions both outside and inside the Capitol concerning public pensions, which is the primary reason I came to testify on behalf of our membership today.

First, neither this hearing nor the current conversations on the pension debt problem in the Capitol should be a referendum on the effectiveness of the defined benefit pension plan as a retirement savings vehicle. Over time, defined benefit pension plans work better than 401ks, studies have shown, by providing higher average returns to employees[i], cost savings for both employers and employees who would have to save more to achieve the same benefit level in a 401k plan[ii], and a reduced risk of poverty in older households[iii]. The caveat is that these plans are superior when they are properly managed. Systematic mismanagement in the form of State agency employer underfunding over a decade-long period – as has been the case in Pennsylvania – cannot be solved by redesigning a system that fundamentally, does not need a redesign.

On March 24, 2015, I offered written testimony to the House State Government Committee concerning the efficacy of Act 120 as a viable option to address the pension debt problem. Despite making annual contributions faithfully to the pension system, the members of SEIU and other public sector workers made historic sacrifices to lower costs to taxpayers, including the following benefit reductions:

- A 20 percent cut in retirement benefits by lowering the pension multiplier from 2.5 to 2.0. This rollback is the same level that existed before Governor Tom Ridge

signed Act 9 in 2001. As a result of this historic cut, new employees are now contributing the same percentage rate for a reduced retirement benefit;
- A groundbreaking risk sharing provision requires employees hired in 2011 or later to contribute up to an additional 2 percent of their incomes if pension investment returns do not meet assumptions. With this risk premium feature the state is unlikely to ever accumulate a large unfunded liabilities in the future, even if a financial market crash occurs.
- The vesting requirement was increased from five years to 10 years;
- The elimination of a "lump sum" withdrawal upon retirement;
- A cap was placed on the maximum pension benefit, so that retirees with longer years of service cannot earn more than their final salary;
- And to qualify for a full retirement benefit, an employee will be required to work to age 65 or meet the "Rule of 92" under which the combination of their age and years of service must total 92, with at least 35 years of service.

The 20 percent cut to the retirement security of nurses, school employees, social service workers and other members in PSERS and SERS since Act 120 took effect is reducing costs to the state by 60 percent. As a result, the cost to the employer providing pension benefits for new school employees, for example, is less than 3 percent of payroll, which is incredibly low. Just as importantly, none of the pension debt – which is the real problem - is associated with the retirement benefits of those new school and state employees hired after Act 120.

SEIU Local 668 stands firmly behind Act 120 and will continue to advocate that the State Legislature let that legislation work over time. However, today, we are here to discuss proposed design changes to pension plans. Recently, there has been public discussion about an as-yet-to-be-filed pension design proposal that both new and current State workers be placed into 401(k) plans. We must state, unequivocally, that the involvement of current employees in such a proposal is not only highly unethical, but is also unconstitutional, as per Article 1, Section 17 of the Pennsylvania State Constitution, which prohibits the impairment of contracts by the State Legislature.

We ask that the members of this Committee not be swayed by partisan brinksmanship or corporate special interests espousing the immediate need to address a so-called pension “crisis” that would ultimately hurt current and future employees. Make no mistake, the **pension debt problem** must be dealt with, and beyond Act 120, Governor Wolf has provided further proposals to address it. But it cannot be addressed on the backs of public employees who have faithfully paid into the system year after year.

A report last month from the Economic Policy Institute[iv] found that moving public employees into either DC or hybrid plans (1) do not help states save money; (2) create more workforce management problems than they solve, specifically high turnover of cash balance plan holders; and (3) increase retirement insecurity. Moreover, while several bills have been introduced or discussed that would close PSERS and SERS to new employees, reduce benefits or create a hybrid model, all have a significant flaw;

none will provide any substantial reductions in the pensions' unfunded liabilities, and some could make the debt much worse.

Switching new employees to hybrid plans should be rejected for the following reasons:

- First, these plans are untested over time. Entrusting the fates of our public employees to an experimental plan, when defined benefit pension plans have been proven to work over time, not only makes little sense, but is irresponsible. This is not a theoretical argument. The results will have real consequences for our members and their families;
- Further, these plans provide relatively little savings for the Commonwealth while weakening retirement security for new public employees
    - The Public Employee Retirement Commission's (PERC) actuary Cheiron's evaluation of the hybrid plan introduced last session by Representative Tobash estimated net cost savings (in present value terms) of only $3.1 billion, while many new employees could see benefit cuts as great as 40%. An analysis of Rep. Tobash's proposal last session provided by the Public Employee Retirement Commission (PERC)'s actuary Cheiron summarized its findings: "*For new employees the loss of retirement security is greater than the value of the cost savings for the Commonwealth.";*
    - An analysis of Representative Kampf's pension bill, HB727[v] shows that, if enacted, the plan will actually cost taxpayers **more** to fund than existing long-term pension costs. The pension reform enacted in 2010 lowered pension costs to new employees to 3.5 percent. The proposal introduced by Rep. Kampf to shift new employees to 401(k)-type plans increases the state's contribution to 4 percent of payroll. Employees left to manage the defined contribution portion of the hybrid plan on their own, would be faced with high administrative fees and lower investment returns as they are not investment professionals;
- They include the transition costs of shutting PSERS and SERS to new members of as much as $44 billion, according to Cheiron in 2013[vi]; and
- They create a need to raise wages to keep compensation competitive to attract new talent, and retain talent seeking other employment when they no longer accrue retirement benefits.

Switching new employees to 401(k) accounts should be rejected for the following reasons:

- Doing so adds $42 billion in additional costs according to an independent analysis conducted by Cheiron in a summary of transition costs contained in SB922 of 2013 (Governor Corbett's 401(k)-style pension) proposal. Cheiron concluded the transition costs are $35 billion for PSERS and $7.2 billion for SERS;
- Switching to 401k accounts makes no progress in addressing the current pension debt or achieving budget relief this year or any year; and
- It will likely increase costs. Alaska closed its pension system in 2005 and pension debt more than doubled by 2013, requiring the state to make a $3 billion

contribution at that time. In another example, West Virginia closed its pension system in 1991 in favor of 401(k)-style plans, but the state later switched back to a defined benefit system to lower costs;

Moreover, 401ks were never intended to be a primary retirement vehicle. They were created as a supplement to pension plans. Even the creator of the plan itself, Ted Benna, acknowledges their failure as a primary retirement vehicle[vii]. As of last month, the National Institute on Retirement Security reported that the median average retirement account balance is only $2,500. For near retirement households, that number is $14,500. Workers do not save enough in these accounts, see their returns eaten up by high fees and/or poor investment choices, and often make withdrawals from them. Retirement benefits for employees would be reduced by as a much as a third to half of what they would have earned in a defined benefit plan due to high 401(k) administrative and financial fees and lower investment returns[viii], which will ultimately reduce consumer spending by retirees and increase the need for community services.

When examining all of the facts: that years of employer underfunding created the pension debt; historic pension reform in 2010 addresses that debt; flawed proposals offered since then do nothing to repay that debt, and could make it worse; the situation is clear. Pennsylvania's low cost, high return pension systems are not the problem, the state has a debt problem.

And it is a real problem, but it should not be fixed by weakening retirement security. Consider not only the impact of the pension debt on future generations, but also the future impact of weakened retirement benefits on our economy. A recent study[ix] noted that 9 of Pennsylvania's 10 largest cities have more (public) pensioners than workers. Our retirees stay in Pennsylvania and spend their money here. NIRS estimated that in 2012 each dollar paid out in state and local pension benefits supported $1.80 in total economic activity in Pennsylvania, 121,615 jobs (or 1.9% of the 2012 workforce levels), $17.5 billion in total economic output, and $2.3 billion in federal, state, and local tax revenue[x]. In your discussions, do not overlook the future loss of economic activity in Pennsylvania if you weaken public retirement benefits. Moreover, consider the probable future increase in welfare expenditures if you attempt to address the pension debt problem by fixing something that is not broken.

As the voice of nearly 10,000 State employees, we will continue to advocate for the retirement security of our members. We support discussions about strengthening the three-legged stool of retirement security - pensions, 401ks, and Social Security. Defined benefit pensions themselves are structurally viable, and we believe it is incumbent on the State Legislature work with Governor Wolf on pension proposals that leverage revenue enhancements and cuts to address the pension debt over time.

Governor Wolf offered a new path forward in his budget address that will provide real relief without needlessly sacrificing the retirement security of hundreds of thousands of people. Among the proposals in his plan is to reduce the debt through the prudent use of a pension bond which has been recommended by several legislators, including Rep.

Glen Grell. The Governor has also recommended cost saving measures to reduce the $700 million in fees paid annually to Wall Street firms and hedge funds to manage pension investments. Further, we encourage you to consider his plan to modernize the liquor store system to improve customer convenience and dedicate the additional revenue to meet the state's obligation to paying down the pension debt. Taken together, these steps would produce savings to reduce our total long term liability by $10 billion and the increased funding for pensions would satisfy bond rating agencies.

We would adamantly oppose such pension proposals for new employees that dramatically cuts retirement security and increases costs by billions of dollars. Such proposals are cavalier uses of public dollars. Rather, we encourage the State Legislature to begin immediate consideration of Governor Wolf's plan, and explore other pension reform proposals that not only address the debt, but **strengthen** retirement security for the men and women who work faithfully and tirelessly for decades on behalf of our Commonwealth.

Thank you.

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[i] "DB Versus DC Investment Returns: The 2009 – 2011 Update" (http://www.towerswatson.com/en/Insights/Newsletters/Americas/insider/2013/DB-Versus-DC-Investment-Returns-the-2009-2011-Update)
[ii] "Still a Better Bang for the Buck: Update on the Economic Efficiencies of Pensions" (http://www.nirsonline.org/index.php?option=com_content&task=view&id=871&Itemid=48)
[iii] "The Pension Factor 2012: The Role of Pensions in Reducing Elder Economic Hardships" (http://www.nirsonline.org/index.php?option=com_content&task=view&id=713&Itemid=48)
[iv] "Will Switching Government Workers to Account-type Plans Save Taxpayers Money?" (http://www.epi.org/publication/will-switching-government-workers-to-account-type-plans-save-taxpayers-money/)
[v] "Pennsylvania Pension Facts: Beware of False Reforms" (http://keystoneresearch.org/pensionprimer11)
[vi] "Memo: PERC Confirms High Cost to Taxpayers of Closing Pennsylvania's Defined Benefit Pensions" (http://keystoneresearch.org/media-center/press-releases/memo-perc-confirms-high-cost-taxpayers-closing-PA-defined-be)
[vii] "Father of modern 401(k) says it fails many Americans" (http://www.marketplace.org/topics/sustainability/consumed/father-modern-401k-says-it-fails-many-americans)
[viii] "Pennsylvania Pension Facts: Beware of False Reforms" (http://keystoneresearch.org/pensionprimer11)
[ix] "Nine of Pennsylvania's 10 largest cities have more pensioners than workers" (http://watchdog.org/207916/pension-pa-york-cities/)
[x] "Pensionomics 2014: Measuring the Economic Impact of DB Pension Expenditures" (http://www.nirsonline.org/storage/nirs/documents/Pensionomics%202014/pensionomics2014_final.pdf)