Testimony of the Pennsylvania State Education Association (PSEA)

Public Hearing Regarding Senate Bill 922

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By
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Good morning Chairman Brubaker, Chairman Blake and members of the Senate Finance Committee. I am Jerry Oleksiak, Vice President of the PA State Education Association (PSEA), and a special education teacher from the Upper Merion Area School District.

We appreciate the opportunity to provide testimony with regard to Governor Tom Corbett's pension plan proposal, which has recently been introduced as Senate Bill 922 and House Bill 1350.

First, I want to assure you that our 183,000 PSEA members and their families take the current pension funding problem quite seriously. This is not just a challenge for the Commonwealth as it considers the current year's state budget. It is also a problem for school districts as they try to build the additional retirement costs into their budgets while still reeling from Governor Corbett's slashing of nearly $1 billion in education funding two years ago.

Together these problems have had an enormous impact on students and school employees. Nearly 20,000 education jobs have been lost, which means class sizes have ballooned, foreign language classes have been cut, and the arts have been eliminated. In addition, extra-curriculars have been eliminated or "Pay for Play" has been introduced. Instructional support and after-school programs have been sharply reduced or eliminated as well.

PSEA members have sacrificed as well. In the face of this, many public school employees across Pennsylvania have agreed to pay freezes and even contract "give backs" in order to help save the jobs of some of their colleagues. The total annual salaries earned by public school employees in our state fell by more than 1.5 percent in 2011-2012, and we would not be surprised to see it fall again in 2012-2013. As a result, the actual amount the Commonwealth and many districts have had to pay in each of these years has been significantly lower than originally projected.

Anyone who feels that school employees have somehow been cossetted from the impact of rising pension costs has been sadly misinformed. What may just be dollars and cents to many lawmakers and school boards balancing a budget, represents the livelihoods of many of our PSEA members and their families.

All of us here today realize that a pension system's unfunded accrued liability is not something that can be ignored. But for the almost ten years leading up to the passage of Act 120 in November 2010, these obligations were routinely ignored, payments were deferred until some distant "tomorrow", and the liabilities were allowed to grow to the present levels. The problem is that "tomorrow" has now arrived.

In 2010, the average state pension plan payment nationally was 89 percent of the Annual Required Contribution or ARC as measured under the Governmental Accounting Standards Board or GASB. To demonstrate the scale of neglect here in our state, PSERS and SERS in the same year had the second lowest percentage of ARC paid in the nation – only 27 percent.

State and public school employees, who have always made their required contributions cannot be blamed for this. School employees in our state have been paying 50 percent more toward the cost of their own pension benefits than the average for similar public pension plans across our nation.

A pension fund's unfunded actuarial liability is a measure of liabilities that have already been incurred but for which payment has not yet been made. It is similar to a debt that has been run up on a credit card. A card that, I might add, currently carries what amounts to a 7.5 percent annual

interest rate. We are now facing the need to pay off the debt long after much of the money was spent on other budget priorities.

It is the debt service payments alone that are causing the employer contribution rates for PSERS and SERS to skyrocket. The actual cost of benefits earned by current state and school employees for work they perform this year has actually been declining with passage of Act 120.

PSEA commends legislators like Senator Browne, Rep. Glen Grell, and many on this panel stepped forward to deal with this issue in 2010.

We worked with them and other legislators from both parties to craft legislation that we could all support. These efforts resulted in passage of Act 120 in November 2010, which contained comprehensive and groundbreaking pension reforms. Reforms, I would add, that are constitutional. Unfortunately, I am not sure that all legislators, the press, and the public recognize the full significance of what has already been accomplished.

Act 120 included major changes to the benefits of future employees:

- A rollback the pension multiplier from 2.5 to 2.0, the same level that existed prior to passage of Act 9 under Governor Tom Ridge back in 2001. This is an effective contribution rate increase for members since they will be paying the same rate, 7.5 percent, for a lower benefit package.
- New employees were then given the option to keep the 2.5 multiplier if they agreed to make higher contributions throughout their career that would cover the full cost of the benefit difference.
- The vesting requirement was increased from 5 to 10 years of service.
- The option of a retiree taking a “lump sum” withdraw was eliminated.
- To qualify for a full retirement benefit, a member 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.

These and other changes in benefits contained in Act 120 are estimated to result in a $33 billion dollar future benefit cost savings for PSERS and SERS over the next 30 years. In fact, the employer normal cost of benefits for school employees hired since June 30, 2011 is now only 2.2 percent. So our new members, who are contributing at the rate of 7.5 percent themselves, are now covering more than 77 percent of the cost of their own pension benefit.

The Pennsylvania Public Employee Retirement Commission noted in its January 2013 Special Report on Funding and Reforming Public Employee Retirement Systems that these employer normal cost rates are among the lowest of statewide plans nationally.

Helping to create this low employer cost was the implementation of a ground breaking risk sharing proposal developed, Sen. Browne and incorporated into Act 120. This new risk sharing component, which shares tenets of a 401(k) type defined contribution plan, will kick into effect once we have three years of experience under the law. Once it does, state and public school employees will be responsible for paying an additional contribution beyond their base contribution rate of 6.25 percent for SERS and 7.5 percent for PSERS in the event that investment returns at PSERS and SERS fall short of their earnings assumptions.

This change, in addition to the other benefit alterations in Act 120 reduced the employer normal cost of retirement to a lower rate than the employer cost would be in a 401(k)-type plan. That bears repeating. Act 120, with a 2.2 percent normal cost, is significantly less expensive than any proposed legislation introduced to date. Currently, the competing cost would be 4 percent under the Governor's proposed 401(a) plan and 6 percent in Senate Bill 2.

While Act 120 did change benefit structures for new employees, it also set forth a commitment of the legislature to a predictable payment plan that will, eventually, payoff the debt of the systems. Now, little more than two years later, and despite that fact that the total employer pension bill is lower than what we expected, the Governor is proposing that the legislature walk away from this payment plan.

The impending pension costs should surprise absolutely no one because Act 120 provided the predictability the legislature sought. These are costs that must and should be paid. This is not just about letting Act 120 work; it is about keeping the pension funds in as strong a financial condition as possible.

Unfortunately, the Governor and his legislative allies, via Senate Bill 922 and House Bill 1350, are attempting to walk away from the commitments made in 2010.

We believe the proposals before you today have several major faults.

First and foremost, this legislation is unconstitutional. The Pennsylvania Constitution contains a clear prohibition against impairment of contracts by the state legislature. The Pennsylvania Supreme Court has twice ruled on the constitutionality of prospective changes to current employees' pension benefits in APSCUF v. State System of Higher Education and Pennsylvania Federation of Teachers v. School District of Philadelphia. In both of these cases, the legislature increased contribution rates prospectively for current PSERS and SERS participants. The court found that the changes unconstitutionally impaired the contract rights of existing members of the retirement systems. The very clear precedent set forth in these cases establishes that a unilateral plan to alter pension benefits for current workers is unconstitutional. The Governor's proposal would cut current member benefits while maintaining contribution rates. This is no different than the situation in the APSCUF case where members were simply required to pay more for each pension dollar they received.

Therefore, the proposed changes to the pension system would not withstand judicial scrutiny, because the Pennsylvania Supreme Court applies a very strict standard to decide the constitutionality of legislative changes to pension benefits under the Pennsylvania Constitution. Under the standard used in Pennsylvania, the court in APSCUF found that pension rights cannot be impaired once a person has *joined* PSERS or SERS.

Most likely understanding this, the Governor is attempting to bypass the Pennsylvania Supreme Court, by establishing a "special tribunal" tasked with determining the constitutionality of Senate Bill 922 or House Bill 1350. The creation of such a court to hear a legal challenge to one specific piece of legislation would be unprecedented in Pennsylvania. Creating an individual special tribunal to decide a challenge to specific legislation contravenes notions of a unified system of justice. The proposal to create this special court is an attempt to fix the appeal by circumventing the jurisdiction of the Pennsylvania Supreme Court, which has already ruled on the constitutionality of legislative changes to prospectively earned pension benefits.

The second major concern with the Governor's proposal is one the Governor himself has complained about in the past. This legislation would implement the same "kick the can down the road" strategy, which lead us to this hearing today. In an apparent effort to provide temporary budget relief, the Governor's plan would defer making the currently required contributions over the next five years. This will simply add the charges to the credit card for future governors and legislatures, which future generations would be left to pay.

Finally, the plan would actually increase taxpayer costs by implementing a 401(k)-type plan for new employees. At its most basic level, we can easily compare the 2.2 percent employer normal cost of benefits earned by new school employees in the current DB plan with the 4 percent employer match under the Governor's proposed 401(a) plan or the 6 percent match under Senate Bill 2. This would represent a cost increase for employers of about one-half a billion dollars a year based on the current total annual salaries for PSERS alone.

But beyond this, it is not possible to ignore, as others have done, the added costs of closing off a defined benefit pension plan like PSERS without dealing with the impact of the system's unfunded liabilities. A series of state-level studies have found that closing off a DB pension plan could increase its unfunded liabilities by as much as one-half.

Federal law requires a pension plan to be fully funded when the last member retires. As a closed plan winds downs and pays out its corpus in the form of benefits, it will have to shift assets towards stable, more liquid investments and correspondingly reduce investment return assumptions. This will in turn raise the cost of funding promised benefits for employers.

To pretend this will not increase taxpayer costs somewhere down the road is a risky gamble. I will refer you to the recent Keystone Research Center paper entitled, "Digging a Deeper Pension Hole: Transitioning to Defined Contribution Plan Brings Higher Pension Debt and Taxpayer Costs." This research paper includes the real life example of what happened in Alaska, which implemented similar changes in 2006.

In fact, the paper also reviews a series of studies conducted in other states that pointed out the same pitfalls in closing off DB plans. Eleven separate studies, let me repeat that, eleven studies conducted in consultation with most of the major actuarial firms in our nation can't all be wrong.

Even more recently, an actuarial cost note on the Governor's Pension Proposal prepared by SERS actuary – the Hay Group confirmed the hidden costs of closing off a defined benefit plan. I would urge the committee to obtain a copy of the actuarial cost note dated May 22, 2013. Instead of producing the cost savings indicated by the Governor's Budget Office, the Hay Group finds that House Bill 1350, which is identical to Senate Bill 922, would be approximately cost neutral.

Put simply, the overwhelming weight of the evidence does not favor a 401 (k) type plan. We will pay significantly for a switch to a defined contribution system.

In addition to the significant general concerns that we have with the Governor's proposal, there are a number of specific items contained within the proposed legislation that raise questions for PSEA. When Act 120 was passed, policymakers went to great effort to ensure that all affected employees were impacted equally. However, that does not appear to be the case within the

current proposed language, and PSEA questions why but our members are receiving disparate treatment. Some of these specifics include:

1. The proposed roll-back for current employees would affect school employees and legislators differently. School employees would see a multiplier reduction to 2.0 and be required to pay a 7.5 percent contribution rate. Legislators would see a multiplier reduction to 2.5 with a contribution rate of 7.5 percent. Both school employees and legislators would be eligible for a multiplier buy up to 2.5 and 3.0, respectively, yet the respective contribution rates would be 12.5 percent and 11 percent.
2. The inequitable treatment continues with school employees hired prior to 1983 being required to pay an extra 1 percent over and above the current contribution rate they pay even though their multiplier will be dropping from 2.5 to 2.0.
3. The proposal would cause public employees with a break in service, most of them women, to be dropped from the current plan and enrolled them in a 401(a) program. About two-thirds of school employees are female, and they tend to retire with fewer years of service, lower final average salaries, and lower pension benefits because so many of them will take at least a small break for child-rearing purposes. The current proposal is far from family friendly. These employees will be greatly penalized for any breaks in service they may have had to raise a child.
4. At present, qualified school employees receive up to $100 a month in premium assistance to purchase medical insurance after their retirement, which covers much less than half the cost of coverage even for a Medicare-supplemental coverage. This is substantially less coverage than is provided to most other public employees.

   The total premium assistance program represents less than 1 percentage point of PSERS' total rate, but it supports the PSERS Health Options Program (HOP) for retirees. The premium assistance has been used to attract new retirees into the PSERS HOP, and these younger lives help to stabilize the cost of insurance for the older retirees. The Governor's Plan would eliminate the program for new hires, which will eventually feed through and affect the quality of coverage and cost of insurance for annuitants currently enrolled in the PSERS HOP.

The rationale for the disparate treatment accorded school employees under the Governor's proposal is unclear. If the increase in contribution rates can be demonstrated to be related to a higher cost of benefits, an actuarial analysis would be helpful to mollify this concern.

In closing, I want to emphasize that PSEA is willing to entertain any meaningful pension reform proposals, as long as they are fair to our current and future members, as long as they are constitutional, and as long as they do not simply pass the buck to future taxpayers at a greater overall cost. The Governor's Plan, unfortunately, fails to meet any of these three criteria, and we are adamantly opposed to that plan. I look forward to answering any questions you may have.