Testimony of
Auditor General Eugene A. DePasquale
Thursday, June 18 2015

Before the Senate Finance Committee
The Honorable John Eichelberger, Chairman
The Honorable John Blake, Democratic Chairman

Chairman Eichelberger, Chairman Blake and members of the Senate Finance Committee, I appreciate the opportunity to provide testimony regarding the status of municipal pension plans in the Commonwealth. In addition to my opening statement, I also included a copy of the special report that my department compiled and released in January that provides a more comprehensive review of municipal pension plans as a whole.

With more than 3,200 local government public employee municipal pension plans, Pennsylvania is unique in that we have more than one-quarter of all such pension systems in the entire country. The Department of the Auditor General is tasked with auditing approximately 2,600 of these municipal pension systems — including police, firefighter and non-uniformed pension plans — that receive state funding under Act 205 of 1984. Nearly three-quarters of these plans have 10 or fewer participants. We perform audits on a rotating basis of over 800 municipal pension plans each year. Our on-going audits of all these plans puts us in a unique position to analyze the municipal pension system as a whole. The report we released in January shows the current status of municipal pension systems in the Commonwealth. While I have included a copy of this 16-page report with my written submission, there are a few details of this report that I would like to highlight.

The total unfunded liability of these 2,600 municipal pensions is now over $7.7 billion, which is $1 billion more than the unfunded liability was in 2011. This is troubling because the increased unfunded liability is getting larger in spite of the growing economy and the stock market performing at record highs. In fact, the report shows that 562 — about 46 percent— of the municipalities that administer pension plans have retirement plans that are classified as distressed because they are under 90 percent funded.

I cannot emphasize enough that this municipal pension issue is not just a “city” problem. It is true that because of their huge population, cities like Philadelphia (population approximately 1.53 million) and Pittsburgh (population approximately 305,704) have a large dollar amount of the unfunded liability. However, the unfunded liability impacts municipalities of all sizes statewide. The five municipalities that have the highest percentage underfunding are (from page 13 in the report):

- Thornbury Township, Chester County – population 3,017 – 22% funded
- Scranton, Lackawanna County – population 76,089 – 23% funded
- Summit Township, Crawford County – population 2,027 – 31% funded
- Ellsworth Borough, Washington County – population 1,027 – 36% funded
- Young Township, Indiana County – population 1,775 – 38% funded

The report identifies 22 severely distressed — funded at less than 50 percent — municipal pension plans. While these are the lowest funded municipal pensions in the Commonwealth, the situation is dire for many municipalities. For example, without legislative action the city of Scranton’s municipal pension funds could run out of money in less than three to five years, possibly forcing one of Pennsylvania's largest cities into bankruptcy. Scranton is not alone in this gloomy projection, many other municipalities will face severe economic impacts due to their ever-increasing pension debt.

The General Assembly will have a major role in saving municipal pension systems across the Commonwealth. My report includes a total of 13 recommendations to consider when looking at how to address the underfunding of municipal pension plans and how to address systemic issues that could help avoid problems in the future.

To address systemic issues, any new legislation should consider:

- Consolidation of local government pension plans into a statewide system segregated by different classes of employees;
- Consolidate the administration of the municipal plans while maintaining the individual pension plans;
- Absent a consolidation plan, municipalities, should use a low cost, conservative method of investing based upon index investing to avoid poor or wildly fluctuating returns;
- Developing portability options for existing municipal employees to allow changing of jobs without fear of forfeiting accrued pension benefits;
- Mandate a lead agency to have responsibility over the plans and provide guidance to the municipalities.

While these recommendations will address systemic concerns, they may not aid municipalities in dealing with the current issue of underfunded pension plans. It is imperative that any legislation also address the underfunding of the municipal pension plans and consider:

- Excluding pension "spiking" overtime and lump-sum payments for accrued leave when determining pension benefits;
- Update age and service requirements for retirement eligibility to account for increased life expectancy;
- Establish consistent member contribution provisions;
- Narrow the range of acceptable rate of return assumptions;
- Establish a new distress recovery program that would amend the current formula of state aid distribution to allow additional state aid based upon distress level;
- Set limits on the amount of pensions costs that may be reimbursed by the Commonwealth;
- Require that each municipality publish its annual pension costs by plan for public review; and
- Reduce administrative and management fee expenses.

The burden of the underfunded and distressed municipal pension plans are the legal responsibility of the taxpayers of each municipality with a distressed plan. Without immediate action by the governor and General Assembly, current recipients of pensions could be at risk of not realizing their lifetime pension payments, and current employees are at risk for their payments to be reduced, or possibly to receive no payments from their pensions. Either scenario will have long-term implications on local municipalities and taxpayers.

Again, thank you for the opportunity to provide testimony. I applaud your effort in taking on this very important issue, and look forward to working with you to help fix the municipal pension crisis.