Testimony

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Thank you, Chairman Metcalfe, Chairman Cohen, and the House State Government Committee for the opportunity to provide testimony on the important issue of public employee pensions. I am David Fillman, Executive Director of AFSCME Council 13.

For some Committee Members who may not understand what 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 Senate Bill 1, which is under consideration here today.

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 more than 20 different labor organizations. The system also covers management employees, the Governor, the General Assembly, the Judiciary, along with certain Institutions such as Penn State University. 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 more than 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 made in 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. That "2012 Spike" was actually being reduced considerably in the mid-2,000 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 and school districts took a perfectly legal holiday on their contributions, which was 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%, out of their pay checks, 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 in 2010, more than 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 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 long term 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 more than 13 years. A regular and recurring COLA typically adds 20% to 30% to the ongoing cost of the pension benefit. Just last week, Louisiana passed a COLA for their retirees of 1.5%

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 more than $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.

So, let's talk about Senate Bill 1, and what it does or doesn't do for the state and school district employees and the taxpayers here in Pennsylvania.

First, as I began my testimony today I spoke about the changing of existing benefits to current employees and how the Courts of Pennsylvania have already ruled that the State Constitution prohibits any reduction to the contractually defined benefit pension. Let me repeat that, CONTRACTUALLY defined benefit pension. Back in 2001, every state and school district employee had to sign a CONTRACT

to increase their payment to the Pension funds, from 5% to 6.25% for SERS and 6.25% to 7.5% for PSERS. If you did not sign this CONTRACT you stayed in your existing CONTRACT of 5%. This is why we believe; along with many legal experts that Senate Bill 1 is unconstitutional. If and when Senate Bill 1 is found to unconstitutional in the Courts, the proposed 18.3 Billion dollar savings over 30 years is reduced by 13.1 Billion dollars over the same 30 years. That 13.1 Billion is the savings the CURRENT employees would be paying into the fund due to the proposed benefit changes. Not to mention the monies lost due to Court cost and re-payment to the employees, as happen in the last Court ruling years ago.

Also Senate Bill 1 re-amortizes the current $53 Billion combined pension systems unfunded liability over a NEW 30- year period; this will produce some additional unfunded liability in the state's future.

Do not just take my word on all this, at the Public Employee Retirement Commission meeting Executive Director Jim McAneny said: "This would extend the time period for the existing payoff of the systems liabilities, which would result in a reduction of the systems annual amortization contribution requirements, but an INCREASE in the unfunded actuarially accrued liability- it's just shifting the repayment of monies farther into the future".

Finally, 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, hazards much worse than the private sector at times. 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, Parole Agents 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 in the country. Unfortunately, 100 AFSCME PennDOT workers have lost their lives over the years 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. Senate Bill 1 removes all Death and Disability Benefits. As stated in the Actuarial Note on Senate Bill 1 "Beyond payment of the participant's account balance to the designated beneficiary upon the death of an active participant, there are NO special death benefit provisions to provide for the surviving spouse or children of a Plan participant. This includes a lack of disability benefits for work-related disabilities incurred by public employees". 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 401 (K) / cash balance system will not address our funding challenges, but will create a host of new problems and challenges in the years ahead.

One last thought, we all hear it's about the taxpayers, everyone in the General Assembly needs to understand that the 104,431 members of SERS, and 267,428 members of PSERS are working paying taxpayers also when we talk about the taxpayers.

Thank you for the opportunity to present testimony to the Committee. And I will attempt to answer any questions you may have at this time.