# TESTIMONY BY
# THE PENNSYLVANIA STATE ASSOCIATION OF TOWNSHIP SUPERVISORS

## BEFORE THE
## HOUSE AND SENATE LOCAL GOVERNMENT COMMITTEES

## ON

## MUNICIPAL PENSION REFORM

## PRESENTED BY

## ELAM M. HERR
## ASSISTANT EXECUTIVE DIRECTOR

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## HARRISBURG, PA

4855 Woodland Drive Enola, PA 17025-1291 Internet: www.psats.org

PSATS Pennsylvania Township News Telephone: (717) 763-0930 Fax: (717) 763-9732

Trustees Insurance Fund Unemployment Compensation Group Trust Telephone: (800) 382-1268 Fax: (717) 730-0209

Chairman Harper, Chairman Wagner, and members of the House and Senate Local Government Committees:

Good morning. My name is Elam M. Herr and I am the assistant executive director for the Pennsylvania State Association of Township Supervisors. Thank you for the opportunity to appear before you today on behalf of the 1,454 townships in Pennsylvania represented by the Association.

Townships comprise 95 percent of the commonwealth's land area and are home to more than 5.5 million Pennsylvanians, nearly 44 percent of all state residents. These townships are very diverse, ranging from rural, agricultural communities with fewer than 200 residents to more suburban, populated communities with populations approaching 65,000 residents.

Currently, municipalities have the option of providing for local police protection based on the will of their citizens. Because of the state mandates for police salaries and benefits, local police protection has become prohibitively expensive.

The Municipal Police Pension Law *(Act 600 of 1955, as amended),* which applies to municipalities with three or more police employees, entitles officers to a defined benefit pension plan which provides participants with 50 percent of their final 36-month average salary payable at age 55 after 25 years of service. Note that age and years of service can be reduced to 50 and 20 respectively if certain criteria are met and these terms are negotiated.

In addition to Act 600's mandatory pension benefits, supplemental pension benefits are currently subject to arbitration, which means that any awards granted by arbitration are on top of the mandated benefits. These awards can be very generous, including medical benefits for retirees; significant sick leave accumulation payable at retirement; significant accrual of vacation time, often with no maximum limit and payable at retirement; and establishment of Deferred Retirement Option Programs (DROPs).

While some municipalities have managed to fund these benefits, reform is needed to restore balance so that quality benefits can be provided in the future at sustainable costs for the valuable and professional service of our police. Without reform, more municipalities will be forced to reduce their forces or become fiscally distressed, which doesn't benefit the municipality or the police.

We believe that the mandated process that yields generous municipal employee benefits must be addressed to truly bring relief to already troubled municipal pension plans, as well as protecting those that are presently sound.

The House Local Government Committee actively worked on the issue of municipal pension reform from 2014-2016. After holding numerous hearings during 2015 in which PSATS participated, discussions culminated in House Bill 414 *(PN 2545)* of 2015, which we supported as a workable solution that would have offered significant reforms and provided a means to offer future officers generous yet sustainable benefits while providing tools to pay down unfunded liability. In addition, HB 414 of 2015 contained several municipal pension reforms advocated by the Auditor General that PSATS also supported.

The draft that we were asked to review contains some elements from HB 414 of 2015 and other earlier proposals. However, the key provisions are either missing or are significantly watered down. In addition, an actuarial analysis is needed to determine the financial impact of the proposal. As such, we must *oppose* the draft in its current form.

**Freeze on pension benefit enhancements**

Critical to the success of municipal pension reform is a cap freezing existing pension benefits at current levels, which would prohibit these benefits and costs from increasing due to collective bargaining and arbitration awards. We can only hope to permanently bring these costs under control and adequately fund benefits currently owed to our police if we stop the future escalation of benefits. Otherwise, we will struggle to fund out of control benefit increases and well-funded pension plans will continue to be an arbitration award away from becoming underfunded.

While there are limits on the expansion of pension enhancements in the draft, it does not provide adequate protection from future arbitration awards. In addition, Sections 508 and 905 of the draft address this issue in what appears to be an overlapping and contradictory manner.

Section 508 of the draft would prohibit any pension benefit enhancements for those plans funded at 80 percent to less than 90 percent; plans funded at less than 80 percent and that receive funding from the bond issue in the draft; and new standard pension plans created by the draft. However, the draft appears to restore bargaining rights once the bond is repaid for those plans funded at less than 80 percent and the new standard pension plans. In addition, Section 508 would leave those plans funded at 90 percent or higher subject to benefit enhancements, provided that employers could not bargain for enhancements that would reduce a plan's funding level below 80 percent. However, this limitation on enhancements does not appear to apply to arbitration awards. Why is this provision in the draft limited to *current* pension plans funded at 90 percent *on the effective date of the act*? If a plan reaches 90 percent funding after the effective date of the act, are there any limits on benefit enhancements?

In contrast, Section 905 of the draft prohibits the *employer* from changing *any* pension plan if it would drop the funding level below 80 percent. This section appears to prohibit arbitration awards that would decrease funding levels below 80 percent, but this is not clear. In addition, Section 905 of the draft would require that any change to a pension plan funded at *less* than 80 percent be subject to approval by the Auditor General. The purpose of the review would be to reject any proposed change that fails to *improve the overall funding ratio* of the plan. Would the Auditor General be required to reject actuarially neutral changes that could reduce administrative costs because the change did not improve the funding ratio of the plan?

The draft does not fully protect pension plans from future benefit increases, and as such, we must oppose this draft as currently written. Sustainable pension plans can only occur if pension benefits can no longer be enhanced now or in the future. Otherwise, municipal pension reform will be in vain.

**Lack of options**

PSATS strongly supports the need for a defined contribution police pension plan as an alternative program for new officers. A defined contribution option would be a sound approach that would provide sustainable benefits for new police officers in-lieu-of a defined pension plan. However, this critical provision is missing from the draft. We cannot support a municipal pension reform plan without a defined contribution option.

Prior legislation provided municipalities with a menu of plan options based on the current funding level of their pension plan. Under HB 414 of 2015, for example, municipalities with plans funded at 90 percent or higher were given the option to change the pension plan structure for new hires to a cash balance plan or defined contribution plan or could choose to keep the existing defined benefit plan. Municipalities with pension plans funded from 50.1 percent to 89 percent could to choose from one of three pension plans for new hires: cash balance, defined contribution, or PMRS. Unfortunately, the draft does not contain these options.

Instead, the draft would mandate that all police pension plans that are less than 80 percent funded establish a standard pension plan for new officers, which appears to be simply another defined benefit plan, as an additional tier within the existing plan. Mandating that a municipality provide a "new" version of a defined benefit pension plan and **not** providing pension plan options for new officers that can be funded without causing fiscal distress, such as defined contribution plans, is unacceptable to our membership. In addition, the draft would require municipalities with pension plans funded at 80 percent or more to keep the existing defined benefit plan for new hires.

We have additional concerns with language in the draft requiring that interest on member contributions be calculated at 4 percent annually, as well the formula for the calculation of benefits. While those officers who are eligible for Social Security would be limited to 50 percent of their final salary, there is no cap on the benefit for those who are not eligible for Social Security. In addition, there is a multiplier that would appear to calculate the benefit at 1.25 times the final salary. Is the multiplier 1.25 as stated in the draft or is it meant to be 1.25 percent (.0125)? In addition, while the draft clearly defines the term "final average salary," it is the undefined term "final salary" that is used for the calculation of benefits in Section 502 of the draft.

**Common sense reforms**

The draft does contain provisions that PSATS can support. This includes recommendations found in the Auditor General's report to the Governor on municipal pensions that would require all municipal employers to comply with the following:

- Assume an actuarial rate of return not to exceed the Pennsylvania Municipal Retirement System (PMRS) rate plus 1;
- Prohibit the use of state pension aid for administrative fees;
- Prohibit deferred retirement option plans;
- Adopt generally accepted accounting standards; and
- Publicly disclose pension data annually.

We also support language in the draft that would exempt municipalities with fewer than 100 employees from following the existing requirements for contracting with professional advisors for their pension plans. Although the municipality would not have to advertise for proposals for these professional services, they would be required to hire a qualified advisor after disclosing that the municipality is seeking an advisor for their pension plans.

The draft would require municipalities to fully fund the annual minimum municipal obligation (MMO), another of the Auditor General's recommendations. In addition, the draft would require the AG to withhold state pension aid if a municipality failed to pay its MMO in the prior year. We must oppose the language in the draft because it does not provide an opportunity for an appeal if the municipality contends that it *did* fully pay the MMO. This could happen due to a paperwork or recording error. In addition, we contend that the language in the draft requiring a municipality to fully pay the prior year MMO *plus* an additional 20 percent before restoring pension aid is unnecessarily punitive. We prefer the language in HB 414 of 2015, which contained an appeal process for those municipalities that were identified by the AG as failing to pay the prior year's MMO; lacked a punitive provision; and gave the AG the option to withhold pension aid.

**Sustainable pension provisions**

Similar to prior proposals, including HB 414 of 2015, the draft would require the transfer of pension plans with less than 50 percent funding to the Pennsylvania Municipal Retirement System, which would manage these plans. While we can accept this provision in the draft, the language needs further refining, including clarification of what happens when a plan becomes better funded. Will a plan ever be permitted to leave PMRS? Why or why not?

The draft would authorize municipalities to lease or sell assets or issue bonds to generate additional revenue to pay down unfunded liability. Note that the bidding timeframe in the draft must last six months, which seems excessive. While we have no problem with this language in the draft, these options are not available for many municipalities as they have no assets to lease or sell and they may need their bond authority for other obligations.

Unlike previous legislation, the draft does provide for new state funding to reduce the unfunded liability of our most significantly underfunded pensions. The Pennsylvania Economic Development Financing Authority would issue bonds to provide a cash infusion to reduce unfunded liability and the debt payments would be financed with pension aid. Municipalities benefitting from the bond would not receive pension aid until the bond is paid in full. Those that don't receive bond funding would continue to receive state aid.

We question why the bond issue in the draft would apply to *all* municipal pension plans that are funded at less than 80 percent, particularly when the bond issue is part of a section of the draft that applies to pension plans funded at less than 50 percent? In addition, municipalities with affected plans would be required to accept the bond funding and see their pension aid diverted. Why couldn't the affected municipalities have a choice in this matter, particularly if their plan is funded at 50 percent or more?

Finally, Section 1502 would require municipalities receiving bond funds to calculate the savings in its reduced MMO and to deposit 50 percent of these savings into their pension plan. Is this the best use of these funds or should the savings go towards decreasing the bond issue and restoring the pension aid payments?

**Closing**

In closing, PSATS and its members appreciates the efforts to address systemic municipal pension reforms, but must oppose the draft as currently written. PSATS is willing to work with both committees to address not only the issues we raised today but other concerns that will arise with the legislation.

I appreciate the opportunity to appear before you today. I would be happy to answer any questions that you may have.