



TESTIMONY ON PUBLIC PENSION ISSUES

by

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to

THE SENATE FINANCE COMMITTEE

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Good morning, chairpersons Browne and Ferlo and members of the Senate Finance Committee. My name is Tom Gentzel and I am the Executive Director of the Pennsylvania School Boards Association. With me today is Tim Allwein, Assistant Executive Director for Governmental and Member Relations.

My purpose here today is threefold: first, to reiterate the magnitude of the increases in the employer rate for PSERS and what they mean for school districts and taxpayers. Second, to offer both a long-range and short-range solution to the problem that we believe will mitigate some of the increase and lower the cost of the system over the course of the next 25 years and third, to urge the General Assembly in the strongest possible way to take up this issue immediately.

The projected increases in PSERS employer contribution rate

We've all been doing ourselves a disservice by calling the upcoming increases in employer contribution a rate "spike." If it were just a spike, then the rate would come down as quickly as it goes up. Unfortunately, that is not what the projections tell us. Employer contribution rates will continue to exceed 20% until the year 2032, creating a 20-year plateau where the rate will exceed 20%. These numbers could change, depending on the earning levels of PSERS investments. Even if those earnings improve, it is not expected that they will improve to the extent that the contributions increases can be significantly altered.

As you have already heard from Mr. Clay, the employer contribution rate is expected to increase by over 700% in the next few years, from its current 4.78% to 33.60% in 2014-2015. Simply put, that means that employers – the commonwealth and school employers - will have to put an amount equal to almost 34% of their payroll into the PSERS fund and continue to contribute in similar amounts for decades afterwards.

School districts have few choices in dealing with this rate increase. Unfortunately, none of them are palatable. First, they can raise property taxes; however, no one wants to even contemplate how much taxes will have to be raised in order to effectively deal with a 700% increase in pension contribution rates, especially given the length of time that we are projected to be in this employer contribution plateau.

Second, they can cut programs. However, it is impossible for most districts to cut enough to pay for the increase and maintain any type of education program that could be considered high quality. Moreover; the state's roadmap for reaching the goals of the federal No Child Left Behind Act (attached) calls for major increases in the percentages of students who need to score proficient on state tests between the years 2011 and 2014 in order for schools and school districts to make Adequate Yearly Progress. Cutting education programs at a time when schools are expected to have more children score proficient on state tests could spell disaster for our commonwealth's public education system.

Finally, symptoms of the nation's sluggish economy add to the bleak picture. Overall decreases in property values, increases in requests for property re-assessments, and lower incomes all result in lower tax revenue for school districts. One can see why this issue weighs heavily on the minds of school board members and school administrators.

Proposed Solutions

Once the pension issue is put on the table by the General Assembly, and we believe that needs to happen as soon as possible, you will undoubtedly hear and see many proposals to fix the problem. In looking at these proposals, we would like to suggest that all legislators keep in mind two principles: Number one: Both a short-term and long-term solution is needed. The short-term solution will help mitigate the immediate increases to the employer contribution and the long-term solution will help to reduce the cost of the system over time.

Number two, the short-term solution has to be multi-faceted in nature. There are several things that we believe can make dents in the amount of contribution rate increases, but alone they will not result in substantial reductions. Taken together, they can make the greatest difference.

PSBA believes that a short-term solution begins with a re-amortization of the system's liabilities over a longer period of time, combined with changes to the benefit package will have the greatest desired effect. Changes to the benefit package should include increasing the vesting time back to 10 years, reducing the multiplier, changing the terms of retirement, including the retirement age, and examining options that are currently available to retirees that are costly, such as the ability to retrieve a lump sum at retirement and receive monthly benefits. PSBA members voted to add a plank to the association's legislative platform this past October which called for support of legislation that "limits eligibility, funding levels and/or the extent of benefit levels so that the employer contribution rate will be substantially reduced and/or provide other sources of revenue independent of the employer contribution rate."

For the long term, PSBA is proposing changing the PSERS system from a total defined benefit system, where an individual's benefits are calculated using a formula and for which the employer bears the responsibility for ensuring that benefits are paid, to a hybrid defined benefits/defined contribution system. This proposal was recommended by a PSBA Pension Study Commission that was brought together in 2007 and consisted of school board members from around the state. Since that time, the concept of the proposal has been approved by the PSBA Board of Directors and subsequently adopted into the association's legislative platform by its members.

The proposal would create a new class of employees, T-E, comprised of individuals who join the system after June 30, 2010. These employees will enjoy the benefits of a defined benefit system, albeit at a lower benefit level, but also have the opportunity to make contributions and control the types of investments in which their contributions are placed through a newly-created defined contribution program. At the time of their retirement, these individuals would reap the benefits earned by both the defined benefit investments and their defined contribution benefits.

The defined benefit features that would be included in the bill for class T-E employees are 1) an employee contribution rate of 3.25% of salary; 2) a multiplier of 1%; and 3) a vesting period of 10 years.

The new defined contribution system would consist of an Individual Annuity Savings Account for all eligible members of the system. Each eligible member would contribute a minimum of 3% of their

salary to the account, along with a mandatory match of 2% of compensation by the employer. Employees could contribute more subject to IRS limitations.

The PSERS Board of Trustees would have the power to make any necessary rules and regulations for the administration and management of the Individual Annuity Savings Plan and have the power to enter into written agreements with one or more financial institutions or other organizations relating to the plan's administration and investment of funds. These rules and regulation include, but are not limited to the following:

- The types of investments that are permitted
- How and when individuals can transfer contributions between investments
- Procedures for deducting amounts to be deferred from members' compensation
- Standards or criteria for the selection for the selection of financial institutions or other organizations that may be qualified as managers of funds deferred under the plan or to provide other services relating to the administration and management of the plan
- Standards or criteria for disclosing and providing options to eligible individuals regarding investments of amounts deferred under the plan
- Standards or criteria for disclosing the anticipated and actual income attributable to amounts invested, property rights and all fees, costs and charges to be made against amounts deferred to cover the costs and expenses of administering and managing the plan or funds
- Procedures, standards and criteria for the making of withdrawals from the plan upon separation from employment or death or in other circumstances consistent with the purpose of the plan.

The bill also modifies the 4% minimum employer contribution floor, so that it would remain in effect in years when the funded ratio of the plan is 100% or more. However this minimum rate would be offset by the amount of funds contributed as part of the defined contribution part of the system.

Also, the bill provides that increases in school district contributions to the pension system would be capped at the Act 1 index. Should the increase in the school district share of the employer contribution rate exceed the current year Act 1 index, the state would pick up the difference between the new employer contribution rate and the index. An additional description of the bill is attached to the testimony. I should add that PSERS staff and their actuaries have reviewed the bill and made several helpful comments so that it is drafted properly.

PSBA is holding a news conference this afternoon to formally announce the introduction of the bill and will undertake various activities in the next few weeks and months to educate its members and the general public about the pension situation.

Legislative action

Finally, I would like to strongly urge the General Assembly to take up the issue of pension reform immediately in 2010. The employer contribution will increase next year by 72% from the current 4.78% to 8.22%, meaning that school district's contribution will jump from 2.39% of payroll to 4.11% of payroll, a significant increase. From 2010-11 to 2011-12, the projected increase is to 10.59%, a jump of almost 30%. That will mark the first time that the employer contribution rate reached double digits since the 1996-97 fiscal year.

School districts need help right now; they cannot wait until 2011 or 2012 for the legislature to act. Unless the stock market improves drastically, the longer we wait, the less impact any legislative action will have on the projected increases to the employer contribution rate. Nothing short of wholesale reform of the pension system will suffice. If we again put a bandage on the problem and move on thinking we have done enough, this same problem will come back another year not too far down the road. This is the perfect opportunity to effect substantive and meaningful changes.

Thank you for allowing me the opportunity to testify on this important issue. I will now be happy to take your questions.