

**Testimony**

**of the**

**AFT Pennsylvania  
and  
American Federation of Teachers (AFT)**

**Presented to the**

**Senate Finance Committee  
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**By**

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Good morning. My name is John D. Abraham, and I am the Director of the Member Benefits Department for the American Federation Teachers (AFT). The AFT is a national labor union representing about 1.4 million workers. Our ranks include teachers, school-related personnel, locals, state and federal government employees, higher education faculty and staff, and nurses and other health care professionals. Nearly 3,000 locals and 43 state federations including approximately 40,000 members of AFT Pennsylvania are affiliated with AFT. The retirement security of our members is of vital interest to both AFT and AFTPA, and I am pleased to present this testimony on their behalf.

At a time of economic recovery from the near implosion of our nation's financial markets and subsequent drop-off in the global economy, it is important to remember what the Pennsylvania School Employees and other State and local governmental sponsored pension plans do for the state's economy. According to a report prepared by the National Institute on Retirement Security (NIRS), in 2006, 340,000 retired Pennsylvania public employees pensions supported:

- 71,000 Pennsylvania jobs that paid \$4.4 billion in salaries
- \$10.5 billion in total economic output, and
- \$1.6 billion in federal, state, and local tax revenues

This important stimulus is keeping many cities and towns afloat and serves as an important counter-weight to a sluggish economic recovery.

#### This Problem was Man-Made

As you wrestle with various proposals to put PSERS and other state pension funds back on solid footing, it's important to remember that the seeds of this problem were sown back in 2002 and 2003 when the General Assembly enacted legislation to keep employer contributions artificially low until FY13. By re-amortizing unfunded liabilities over 30 years while re-amortizing past investment gains over ten years, the link between liabilities and assets was broken. This action significantly contributed to the drop in PSERS funded ratio from a high of 123% in 2000 to 86% as of June 30, 2008. Had Act 40 not been passed, and our employers been required to pay their fair share of pension costs over the last 10 years, we would not be looking at such a steep ramp-up in employer costs that are projected to hit about 30% of pay by 2013. While the State and School districts contributions were cut in half, employees continued to pay their full 7.5%.

## Going Forward

While you are under pressure from tax-cutting groups to cut teacher pensions and even switch from a defined benefit plan to a defined contribution plan we urge you to keep in mind the following concepts:

- Although the phrases “defined benefit” and “defined contribution” sound similar and appear to be interchangeable to the uninformed, nothing could be further from the truth. The defined benefit plan provides a modest but guaranteed lifetime benefit that pools longevity risk and investment risk, and permits a dignified and secure retirement. For Pennsylvania educators the annual benefit is about \$22,000. The defined contribution plan shifts both longevity risk and investment risk to each individual retiree, and leads to retirement insecurity. It forces them to become expert investors or hire someone to help them. It also forces them to conserve their account balances for an uncertain future.
- When the cost of providing the same target benefit is modeled for a defined benefit pension and a defined contribution plan, the cost of the defined benefit is about 50% less. Several embedded features of defined benefit plans make them more efficient.
  - First, defined benefit plans only have to save for the average life expectancy of the entire group, (about 17 years for men and 20 years for women at age 65). Defined contribution participants must save for a much longer period of time to avoid running out of money.
  - Second, defined benefit plans don't age. Therefore they can maintain investments in a diversified portfolio over time because they have a longer investment horizon than individuals. Defined contribution participants must necessarily shift to more conservative investments as they get older to protect against market shocks. This shift leads to lower returns, which requires the participant to contribute more money to provide the same benefit as the defined benefit plan.
  - Third, defined benefit plans use their group purchasing power to hire professional money managers at lower fees. This combination typically results in investment returns of about 1% more each year for defined benefit plans over a defined contribution plan. This differential leads to a cost savings of about 25% over a career versus the contributions required to a defined contribution plan.
- States that have switched to defined contribution plans, like Alaska, Nebraska and West Virginia did not experience any short-term relief as they had to pay for two pension plans and not one. Moreover, Nebraska and West Virginia

switched back to the defined benefit plan as they found that neither taxpayers nor employees were getting a good deal for the money that was being spent. Alaska reports that the state is having trouble recruiting and retaining a high quality workforce since its 2007 shift to defined contribution plan concept. Again, it is important to note that, even if a defined contribution plan was adopted today, Pennsylvania would still have to pay the projected 2013 spike on the defined benefit plan of about 30% plus the cost of the new defined contribution plan.

- The guaranteed lifetime benefit feature of the defined benefit plan is especially important to women who typically outlive their husbands or are divorced or never married. Without the guaranteed lifetime benefit, women would be forced to amass more assets for retirement to meet their longevity risk. As over 70% of Pennsylvania educators are women, policy makers need to be mindful of how any change in plan design will affect this group of workers.

Everyone should be able to retire in dignity after a career of work. I believe that a worker needs three things to meet this standard:

- 1.) 100% pre-retirement earnings from all sources of retirement income, including Social Security, pension and personal savings,
- 2.) COLA to protect the purchasing power of the pension after retirement, and
- 3.) Health insurance that meets a retiree's health care needs.

While the replacement rate for a long-term educator is reasonable, both the COLA and health care standards are ripe for review. The 1998 and 2002 COLA ad hoc payments covered about half of the rise in living costs when granted. However, there has been no adjustment since 2002. The impact on the living standards on the most senior retirees is devastating. We urge you to consider the plight of these retirees as you consider making changes to this plan.

#### Conclusions and Recommendations

It is an important responsibility to make sure that the pension benefits of hundreds of thousands of Pennsylvania educators and public employees are being properly managed. PSERS has been in existence for almost 100 years and has faced down all types of economic adversity and prevailed. It is important to note that each generation of retirees has always received a pension benefit, because the state has continued to keep the promise to fund its share of costs. We applaud the Committee for taking its oversight responsibilities seriously by holding these hearings. We recommend that you consider the following themes to guide your deliberations:

1. Required contributions should always be paid when due, in good times and bad.
2. Until the financial meltdown at the end of 2008 and beginning of 2009, PSERS was 86% funded, which exceeds the 80% considered by most experts to be an adequate standard for prefunding a public plan.
3. As state pension plans are pre-funded, there is enough money on hand to meet promised benefits for many years to come.
4. The funding problem was man-made and not due to a flaw in the defined benefit plan.
5. Defined benefit plans complement employer needs for a long-term quality workforce. They also provide for the orderly transition of workers into retirement.

Thank you for this opportunity. We look forward to working with you in the days ahead to craft necessary changes to put plan funding back on a sustainable track. AFT and AFTPA are committed to work with you to find a long-term solution that is fair to plan participants as well as the public.