



TESTIMONY ON PUBLIC PENSION ISSUES

by

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to

THE SENATE FINANCE COMMITTEE

December 16, 2009

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.

Required Proficiency Percents Math

<i>Year</i>	Intermediate (stepped) Increments	Linear (annual) Increments
2002	35	35
2003	35	40
2004	46	46
2005	46	51
2006	46	57
2007	62	62
2008	62	67
2009	62	73
2010	78	78
2011	78	84
2012	78	89
2013	94	94
2014	100	100

*** Note: Schools are evaluated for School Improvement every year regardless of increment method adopted.**

Required Proficiency Percents Reading

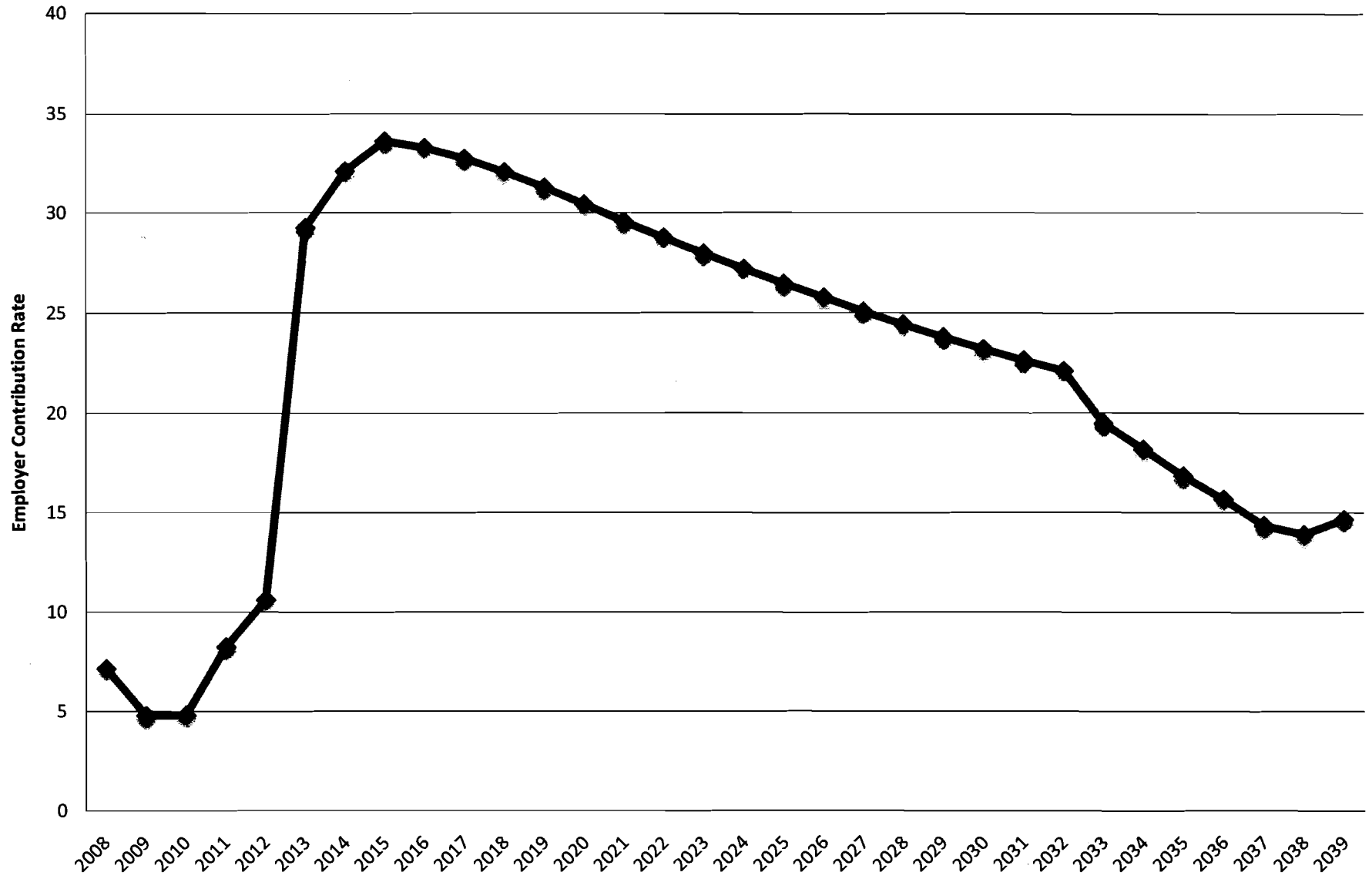
<i>Year</i>	Intermediate (stepped) Increments	Linear (annual) Increments
2002	45	45
2003	45	50
2004	54	54
2005	54	59
2006	54	63
2007	68	68
2008	68	73
2009	68	77
2010	82	82
2011	82	86
2012	82	91
2013	95	95
2014	100	100

*** Note: Schools are evaluated for School Improvement every year regardless of increment method adopted.**



PSERS Total Employer Contribution Rate Projections

December 11, 2009





the **PENSION CRISIS**

PSBA Pension Study Committee Recommendations

Background:

Pennsylvania school districts have been bracing for a major increase in the employer contribution rate for the Public School Employees' Retirement System (PSERS). Thanks in part to the poor performance of the stock market and an increase in retirement benefits for school and state employees under Act 9 of 2001, a massive new expense was created that will affect the retirement system for many years to come.

The employer contribution rate has been set at 8.22% for the 2010-2011 school year. This represents a 72% increase over the 2009-10 rate of 4.78%. The latest projections from PSERS forecast the employer rate to exceed 20% in 2013 and spike to almost 34% by the year 2015. Although the rate will begin to decrease in 2016, it will continue to exceed 20% until the year 2032. This 19-year "plateau" of employer contribution rates greater than 20% would exceed a level of expenses for taxpayers, school districts and the commonwealth unparalleled in the 92-year history of PSERS. .

The current state of the state's pension systems and the factors leading to that condition should not soon be forgotten. The fact that the employer contribution rate, funded by the state's taxpayers, is projected to increase by so much has raised fundamental questions about the appropriate type of pension system the Commonwealth should have for its public employees and how much taxpayers are prepared to support.

School officials, legislators and others have acknowledged a national trend in which private employers replace guaranteed pension benefits based on years of service, known as "defined benefit" plans, with "defined contribution" plans, where the amount of benefit depends on the amount contributed to a retirement plan by employers and employees and investment returns on those contributions.

PSBA Pension Study Committee:

In 2006, several school boards proposed to the PSBA Platform Committee that the association officially support a change to a DC plan for public school employees. The Platform Committee, realizing the policy and financial impact of such a change, deferred action and asked the PSBA Board of Directors to create an *ad hoc* Pension Study Committee to examine the issue and to formulate a policy recommendation for consideration.

The Pension Study Committee, chaired by 2008 PSBA President Pamela Markle and comprised of school directors from across the state, met on several occasions during the first half of 2007. At these sessions, the committee members learned about how

PSERS currently operates, heard arguments from advocates on both sides of the DB/DC debate, was briefed on a new trend for creation of hybrid plans, and discussed various options for change in Pennsylvania.

The committee's charge was two-fold: 1) formulate policy recommendations to the PSBA Executive Board, which in turn would advise the association's Platform Committee and Legislative Policy Council; and 2) develop information about this important topic that can be used to enable the PSBA membership and other stakeholders to have a better understanding of school retirement issues.

The committee then developed a final report that contained specific recommendations. The report and the recommendations were endorsed by the PSBA Board of Directors in July and by the 2007 Platform Committee in August.

In October, 2007, the PSBA Legislative Policy Council, consisting of voting delegates from PSBA member entities, approved the association's 2008 Legislative Platform that included two new recommendations of the Pension Study Committee. These items were reaffirmed in October 2009 for inclusion in the 2010 platform and a new item, described below, was added.

The Recommendations:

As a primary focus, the PSBA Pension Committee examined arguments in support of and in opposition to changing the type of plan PSERS operates from defined benefit (DB) to defined contribution (DC) and considered other related matters regarding public pensions. The committee recommended measures to address both long-term and short-term reforms.

Long-Term Reform – PSBA would support the establishment of a two-tier retirement system, one for current public school employees and another for those hired after a specified date, preferably as soon as possible. The existing DB plan would be maintained for all current active members of PSERS, with existing benefits remaining unchanged. For public school employees hired after a specified future date, create a *new* hybrid plan, containing features of both a DB plan as well as a DC plan.

The school district portion of the employer contribution rate for both pension plans would be capped at the Act 1 index. The Commonwealth would fund any remaining employer obligation. In the event that Act 1 would be repealed or changed, the employer contribution rate for both pension plans would be capped at a figure calculated in the same manner as the Act 1 index or successor index that is enacted limiting the increases in school district taxation, whichever is less.

PSBA would oppose enactment of any new benefit enhancements, for either plan, and assign to PSERS responsibility to administer the benefits for both plans and to manage their assets.

Pension Hybrid Legislation

The legislation being proposed represents the committee's long term solution to the pension issue. As described previously, PSBA is calling for the creation of a hybrid

pension system for school employees, one that combines the advantages of a defined benefit and a defined contribution system.

The bill 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.

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The PSERS Board of Directors 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:

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- Standards and criteria for disclosing and providing options to eligible individuals regarding investments of amounts deferred under the plan
- Standards and 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.

Legislators have told PSBA that the hybrid solution will be a part of the discussions and debate on pension reform that will likely happen in early 2010.

Short-Term Reform - PSBA would support legislation that would require that the employer contribution rate floor for PSERS' existing plan be raised to the employer normal cost. The association also supports implementing the Fresh Start approach, which revalues PSERS' assets to market and re-amortizes its current and future gains and losses over 30 years. However these are only two of the potential short-term solutions. PSBA members added a third item to the association's 2010 Legislative Platform calling for support of legislation that would require the General Assembly to adopt changes to the PSERS system to limit eligibility, funding levels, and/or the extent of benefit levels so that the employer contribution rate will be substantially reduced and provide other sources of income to the system other than the employer contribution. The addition of this item to the platform gives staff and the association the flexibility to support a wide variety of changes that would, in the short term, reduce pension costs to school districts, including lengthening the vesting period, changing benefit options, changing smoothing periods and other solutions that could help in the short-term.