psba

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 supports 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.

The new defined contribution system would create 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 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:

- 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 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.