



Pennsylvania State Association of Boroughs

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Testimony

of

Chris Cap

**Deputy Executive Vice President,
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on

Senate Bill 596 (Printer's No. 646)

**Before the
Pennsylvania Senate Finance Committee**

Wednesday, October 17, 2007

Introduction:

Good Morning Chairman Brown and members of the Senate Finance Committee. I thank you for inviting us to testify today on Senate Bill 596 (P.N. 646), a proposal that would significantly liberalize police pension benefits through the establishment of a statewide municipal system.

My name is Chris Cap and I serve as the Deputy Executive Vice President of the Pennsylvania State Association of Boroughs (PSAB). I am also a member of the PERC Municipal Pension Advisory Committee, which is comprised of both local government advocates and municipal union interests. Joining me today is Mr. Thomas J. Anderson of Anderson & Associates, who has serviced municipal pension plans for a total of 27 years as a consultant and as a public servant in the Pennsylvania Office of the Auditor General – Office of Municipal Pension Audits.

Background:

PSAB has represented the 959 boroughs of the Commonwealth since 1911. Our Association is dedicated to supporting elected and appointed borough officials in their efforts to deliver essential public services to over 2.6 million taxpayers statewide.

The police personnel that our boroughs employ are an important service component to our communities. Unfortunately, infrastructure maintenance costs and other essential areas on the local level have spiraled in recent years, which presents significant fiscal challenges for our membership. Police service remains as one of the primary budget areas that can account for 30-50% of local budget expenditures. This line item routinely includes personnel wages, safety equipment, patrol cars, overtime hours, and benefit costs (pension, health etc).

To attain quality police personnel, all boroughs that are subject to Act 600 are mandated to provide a defined benefit pension for their officers. Presently, there are 492 borough pension plans in the Commonwealth and our local governing councils have strived to effectively provide this benefit to our dedicated police officers and just as importantly, their families.

In putting the current municipal police labor situation into some perspective, our members have consistently indicated that police recruitment efforts have been met with overwhelming response rates and the crop of eligible police candidates have exceeded recruitment goals. In our judgment, these supply conditions indicate that borough benefit packages are already above optimal levels necessary to secure an effective public safety workforce.

PSAB does not believe that municipal benefit standards are a barrier to attracting career candidates that wish to enter the police profession. We further assert that the \$75 million in additional benefits proposed under Senate Bill 596 is not necessary to attract police talent when one considers the current supply/demand labor model.

Analysis & Objections:

PSAB opposes Senate Bill 596 on numerous grounds and has objected to this concept in each of the previous six sessions of the General Assembly. A number of baseline factors should be analyzed when considering if local governments should be mandated to enter the State Employee Retirement System (SERS).

Our initial thought is the actuarial funding troubles of SERS and the Public School Employees Retirement System (PSERS). Their actuarial positions have been well documented and recent reports indicate that \$1.376 billion in taxpayer contributions will be required in 2011-12 and the figure will dramatically jump to \$4.176 billion in 2012-13. The actuarial conditions of these state administered pension funds warrant concern.

Many of the problems at PSERS and SERS may be directly attributed to Act 9 of 2001 and Act 38 of 2002, which provided benefit enhancements for state employees and teachers. To further complicate matters, the stock market dramatically under performed rate of return assumptions and all surplus moneys in the fund subsequently evaporated. Act 40 of 2003 was later signed into law to essentially defer or refinance these obligations through an extension of the amortization from ten years to thirty.

Relating these events and potential lessons back to Senate Bill 596, we are concerned this legislation may injure municipal plans much like Acts 38 and 9 adversely impacted SERS and PSERS. At a time when many states and private sector entities are turning to defined contribution plans, Senate Bill

596 liberalizes benefits and seemingly runs counter to national benefit trends (public/private sectors) which are to ease employer liability exposure.

In reviewing the public pension environment around the country, a dramatic reassessment of policy objectives is underway. Illinois, Utah, Ohio, and Virginia are looking to move their public employees into defined contribution plans. Meanwhile, California is strongly considering measures that would raise the retirement age for state workers from 55 to 65 and even amend age provisions for municipal police officers from 50 to 55. In Rhode Island, the Providence City Mayor is promoting a plan to close the city's pension system to new employees and move them into defined contribution plans. Neighboring New Jersey municipalities already fall under a statewide pension plan for their police and fire employees. The results have been disastrous, as the Garden State's municipalities were mandated to increase their employer contributions by 81% in 2007, which followed a painful 119% increase in 2006.

The subject of city "bailouts" has been a hot-button issue with our members across the Commonwealth. This legislation leaves open the opportunity for assets of well-funded plans to subsidize distressed city plans such as Pittsburgh and Philadelphia, who together account for 75% of all unfunded accrued municipal liability statewide. Some city officials have called for a bailout of their plans through a statewide system, which an overwhelming majority of our members object to. PSAB believes that boroughs should not be penalized for exercising sound fiduciary responsibility and then mandated to participate in a struggling state system or be positioned to supplement other plans that may have an inordinate number of disability claims.

Another major concern is SERS 30% investment allocation in non-SEC regulated hedge funds. These types of investments are being scrutinized by Congress and are widely recognized as higher risk ventures with little transparency (and low liquidity) to investors. This investment strategy is likely designed to make up for sharp actuarial shortfalls in the SERS state system. In considering the financial condition of SERS, we will not judge if this is a prudent investment policy for their set of circumstances. Higher risk for greater reward appears to be the approach they have adopted, yet with the enhanced risk may come a steeper downward slope in volatile markets. Comparatively, many municipalities have successfully managed their risk by implementing asset allocation formulas that employ a mix of equities and bonds that are regarded as more conventional.

In considering these factors, PSAB concludes that a major incompatibility in investment approaches between SERS and municipal pensions exist. Local governments generally don't pursue these alternative investment avenues, particularly in the wake of the recent sub-prime mortgage crisis and it's triggering of hedge fund meltdowns such as the one recently experienced by Wall Street heavyweight, Bear Sterns.

Under this proposed measure, future benefit enhancements and individual retiree calculations would be made in Harrisburg and therefore circumvent local oversight. Another likely consequence is that liberalized benefits would be magnified under GASB 45 and municipalities may face enhanced barriers to credit markets and infrastructure bond issuances. Banks and bond underwriters would factor these legacy costs into their credit pricing decisions, which may result in higher costs to taxpayers for the increased credit risk.

Redundancy is another concern since the Pennsylvania Municipal Retirement System (PMRS) is already in place and available statewide. Why should the municipal pension system be subjected to further fragmentation through the establishment of GERS? This proposal would create yet another level of bureaucracy, which local governments would be required to interact and report to (further inefficiency). This sharply contradicts the supposed legislative intent of the bill.

Finally, we would like to take a few minutes to clarify three (3) points from the PERC testimony delivered at the October 3, 2007 Senate Finance Committee meeting.

First, an issue was stated that benefit improvements would no longer be arbitrated and that Act 111 would be eliminated. According to Section 5405 subsection (c) this is not the case. Subsection (c) states that a local government may designate a higher class of service multiplier subject to any collective bargaining agreement, mediation agreement, or arbitration award.

Second, the establishment of simplified employee pension plans for part time local government police employees as addressed in Section 5410 (a) would undermine the administrative efficiency and centralized investment management as advocated by the proponents of this bill. According to this provision, any simplified retirement plan must be established and

administered by the governing body of the local government. In addition, this additional municipal contribution would only increase the liability that local governments face.

Third, the addition of a supplemental local government retirement benefit accumulation plan, as addressed in section 5442(a), will only increase costs for local governments. While this may be an optional benefit, this provision is subject to collective bargaining or arbitration. It should be noted that the specified contribution made by the employee must be matched by the local government. It is also important to note that this supplemental cost is in addition to the annual financial requirement of the local government's municipal pension plan. State aid could not be used in offsetting this supplemental cost.

It would be fair to question if the methodology utilized in the PERC fiscal note indicating a \$75 million benefit enhancement is valid. The labyrinth of provisions contained in this 151-page bill may not all be accounted for. This is a major point of concern that should be carefully considered.

In closing, we believe that one investment approach does not fit all in the case of a statewide pension system and the degree of appropriate investment risk simply cannot be effectively calibrated from Harrisburg. Additional benefit enhancements will further injure municipal plans as it has with the state systems. Furthermore, Senate Bill 596 short-circuits local oversight and takes away the ability of locally elected officials to conduct their fiscal due diligence and terminate poorly performing investment managers that fail to meet benchmark indexes. Our members are accountable to their constituencies, yet we are concerned that a statewide system would not be accountable to local governing bodies for poor investment and administrative performance.

I wish to again thank you Chairman Brown and the members of the Senate Finance Committee for extending us the opportunity to testify on this legislative proposal. Mr. Anderson and I would be more than happy to answer any questions you may have at this time.

Respectfully submitted,
Chris Cap
PSAB Deputy Executive VP
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