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Memorandum

To: All House Members

From: Representative Warren Kampf

Date: May 18, 2012

Subject: Co-sponsorship of Comprehensive Defined Contribution Legislation

Colleagues,

As I am sure you hear everyday from the school districts in your District, ever-rising pension obligations are crippling budgets and threatening the continued delivery of a quality education for our children. In addition, both independent and government estimates show pension obligations to be underfunded by at least $30 Billion. My view – and the view of many others in our state – is that this system is coming dangerously close to insolvency and we are reaching "crisis mode."

To address this issue and begin to provide relief to both Pennsylvania's taxpayers and school districts, I am seeking your co-sponsorship on legislation that will eliminate pensions for all new hires at both the school and state levels, including those in higher education. The only excluded group will be state police, because they do not contribute to Social Security.

Some highlights of the plan:

- Mandatory Employer Contribution of 4%
- Minimum Employee Contribution of 4%
- Any person currently enrolled in the DB plan can choose to close their benefit and move to the new DC plan and receive an annual 7% contribution from employer. This will entice some existing members to transition, and given the increasingly precarious status of the funds, this could happen at an even greater pace. While this will not eliminate the unfunded liability that already exists, it will help to reduce our risk going forward.
- The State Police have been exempted from this legislation since they do not contribute to Social Security.
- Any new hire in the Higher Education system currently eligible for SERS or PSERS will be required to join the existing Higher Education DC plan.

Our alarming underfunding is the result of a history of human errors. We did not get into this position overnight and we will not get out of it overnight. None of the options available to us are painless; with or without change, over the coming years we will be required to provide funding to this broken system at tremendous rates to make ends meet. But the true reform I am proposing will allow us to stabilize our liability for the future and reduce costs and risks for the taxpayers of this Commonwealth. To do nothing, of course, would be the greatest error of all.

Opponents of this plan will argue that switching now could increase costs in the short term – and even possibly in the long term. Their attacks will be based on actuarial estimates in valuing the existing liability and paying it off. Of course, these same opponents are the people who have ignored the actuaries in the past when putting us in the position we now face.

My legislation has attempted to craft an actuarial funding plan that eases, or does not increase, the cost in the near term. Without change, however, costs in the longer term will undoubtedly increase. While the funding plan included in this legislation is open to debate and discussion, and to brighter minds than my own, I know it would be a huge mistake to continue to add new hires to the already broken system under which we currently operate.

There will be some start-up costs associated with this process, and these are not addressed in the legislation, although I believe they will not be very large given that the existing SERS and PSERS Boards and their employees will be doing the work and administering the new plan. Eventually, the participants in the plan will pay fees sufficient to pay for its administration. I also anticipate much of the administration will be done by a third-party administrator, although the plan will give flexibility to the Boards. Think of the many mutual fund companies that do this for private employers; they could and should do this for this plan. Also, while I have given large flexibility to the Boards to make decisions, I hope we can put a stop to the current practice (in at least one of our pension funds) of the direct managing of investments by government employees, and even by the creation of an in-house trading floor. These are not core functions of any government. My view is our employees and appointees for these plans should be acting as fiduciaries only, and not stock market traders.

Finally, I am sure some opponents will say that change occurred in 2010 and we should give those actions time to take root. But that effort did two things that will never result in the reform that is needed: first, it preserved the defined benefit plans for new hires and, second, it only refinanced our obligations, pushing the unfunded liability payments off to the future while increasing their costs. While refinancing is a tool we are going to need to solve the problem – and a tool I utilize in my legislation – it is not the solution.

Without change, we will only perpetuate the risk to taxpayers and leave this problem for other sessions of this body to confront. To use an old phrase, the definition of insanity is doing the same thing over and over again expecting a different result. The proposal I am making is an effort to stop the insanity. I look forward to your co-sponsorship of this concept, your suggestions as we move forward, and to a result that both makes fiscal sense and satisfies Pennsylvania's citizens that we have heard their message to get out of the pension business.

I look forward to hearing from you as we move forward in addressing one of the most vital issues to the future of our Commonwealth.

Please contact Joni Mitchell in my office at 717-260-6166 or jmitchel@pahousegop.com if you wish to sign on to this important legislation.