COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES
HOUSE FINANCE COMMITTEE

RYAN OFFICE BUILDING
ROOM 205
HARRISBURG, PENNSYLVANIA

MONDAY, FEBRUARY 25, 2008
2:00 P.M.

BEFORE:

HONORABLE DAVID K. LEVDANSKY, CHAIRMAN
HONORABLE STEVEN R. NICKOL
HONORABLE SCOTT W. BOYD
HONORABLE GORDON DENLINGER
HONORABLE BRIAN L. ELLIS
HONORABLE FLORINDO J. FABRIZIO
HONORABLE DAN FRANKEL
HONORABLE JARET GIBBONS
HONORABLE C. ADAM HARRIS
HONORABLE DAVID R. KESSLER
HONORABLE MICHAEL PEIFER

BRENDA S. HAMILTON REPORTING
P.O. BOX 165
ELM, PENNSYLVANIA 17521
717.627.1368 FAX 717.627.0319

(CONT'D)

HONORABLE DAVE REED
HONORABLE CHRIS SAINATO
HONORABLE TIM SEIP
HONORABLE JOSH SHAPIRO
HONORABLE RANDY VULAKOVICH

ALSO PRESENT:

HONORABLE MARK B. COHEN
ROBERT KASSOWAY, MAJORITY EXECUTIVE DIRECTOR
ANDREW RITTER, MINORITY EXECUTIVE DIRECTOR
ERIC MOCH, RESEARCH ANALYST

BRENDA S. HAMILTON, RPR
REPORTER - NOTARY PUBLIC

INDEX

P R O C E E D I N G S

- - -

CHAIRMAN LEVDANSKY: Good afternoon. This is a public information meeting of the House Finance Committee. Earlier this session there was a change in the jurisdictions of some of the standing committees in the House and the issues that they're charged with -- with addressing.

It used to be that all the pension-related pieces of legislation would either be assigned to the House Local Government Committee, the House State Government Committee, or the House Education Committee.

But when the -- the Gaming Committee was -- was created, the decision was to move all legislation pertaining to gaming, and small games of chance and things like that, to move those issues out of the House Finance Committee and into the -- the newly created Gaming Committee and instead to move some of the legislation dealing with pension issues under -- into the jurisdiction of the House Finance Committee.

So this week is an opportunity for the members of the committee, myself included, to gain a better familiarity of our -- of our pension systems in the state, from those at the municipal government level to the school district level and to the state level as well.

And so today we're -- we're -- we've invited experts in the field of municipal pension systems to testify before the committee and -- and provide us with some overview and some understanding of municipal pension systems.

Tomorrow the Finance Committee will have a hearing that we'll have witnesses and experts from the State Employee Retirement System and the Public School Employee Retirement Systems to testify before the committee as well.

And then on Wednesday, as a follow-up to the last committee meeting, when members had raised questions and concerns relative to the state bond indebtedness, we're going to have testify before the Committee Budget Secretary Michael Masch to address that issue of the state's bonding indebtedness.

So with that, before we -- before we get started, let me recognize my -- my colleague, Representative Steve Nickol.

REPRESENTATIVE NICKOL: Thank you, Mr. Chairman.

I -- I think it would be a good move and for my own -- from my own perspective to try to get pension issues under the jurisdiction of one committee. Mainly because so many of these issues are so complex and dividing it up with staff for three separate committees ends up with the staff really not being all that familiar or gaining that much expertise on pension issues.

And I think it would be good from the perspective of having one committee who are -- with staff and members who are up-to-date, so to speak, on these issues.

And so in that respect, if this committee is going to be handling more -- a larger share of pension issues, I think it's great that the Chairman has scheduled this primary, I guess you could call it, on pension issues by having all the major players, starting with the Public Employee Retirement Commission, who is an arm of this General Assembly in terms of providing advice on pension issues.

I applaud him for these hearings.

CHAIRMAN LEVDANSKY: Thank you. And just one other -- one other thing. I just want to follow up to what Representative Nickol just said.

Just let me take this opportunity to, Steve, once again, public -- publicly acknowledge your contribution to the legislature, having, I think, a considerable understanding of pension issues.

Steve has a considerable understanding, Representative Nickol has a very considerable understanding of pension-related systems relative to the state.

My only disappointment is that he won't be -- that he won't be seeking re-election to continue to provide his expertise in this area. So -- regretfully.

And so what I'm going to do between now and the end of the year, Steve, I'm going to use your expertise as much as I can. Okay?

With that, let me have the members of the committee introduce themselves starting on the far right.

REPRESENTATIVE VULAKOVICH: State Representative Randy Vulakovich, Allegheny County.

REPRESENTATIVE PEIFER: Mike Peifer, the 139th District, which is Pike, Wayne, and Monroe.

REPRESENTATIVE DENLINGER: Gordon Denlinger, eastern Lancaster County.

REPRESENTATIVE HARRIS: Adam Harris, Juniata, Mifflin, Snyder.

REPRESENTATIVE BOYD: Scott Boyd, part of Lancaster County.

REPRESENTATIVE NICKOL: Steve Nickol, Adams and York Counties.

REPRESENTATIVE SAINATO: Chris Sainato. I represent Lawrence and a small section of Beaver County.

REPRESENTATIVE FABRIZIO: Flo Fabrizio, Erie County.

REPRESENTATIVE SEIP: Representative

Tim Seip. I have the Cabela's and the game land district.

REPRESENTATIVE KESSLER: Hard act to follow there.

Dave Kessler, southern Berks.

CHAIRMAN LEVDANSKY: Thank you. With that we'll introduce Mr. James McAneny, the Executive Director of the Public Employees Retirement Commission.

DIRECTOR McANENY: Well, thank you, Mr. Chairman. I realize you had promised everyone they'd have experts on pensions to speak today, but you're stuck with me instead.

This is a really interesting area of the law and of the -- of legislation to those of us who don't bore too easily.

You're going to find that there is -- are roughly 15 state statutes governing the operation of local government pensions in Pennsylvania. That does not include the Tax Codes, the Internal Revenue Code, the Pennsylvania Inheritance Codes, or the Probate, Estates, and Fiduciaries Codes dealing with fiduciary responsibilities. This is just pure pension stuff.

The state systems are much simpler because there's one statute for each of the two state systems, main state systems.

You're going to hear from Jim Allen later this afternoon from the Pennsylvania Municipal Retirement System, which is part state system and part administrator for local government systems, which can go right back to that, who knows what it's going to be.

The role of the Public Employee Retirement Commission really is twofold. One is regulatory. We have an administrative function, a regulatory function within what's called Act 205 of 1984. That's the General Municipal Pension Systems Recovery and State Aid Program.

The regulatory function deals with ensuring that each pension plan files actuarial reports on a biennial basis and that they then fund their pension plans in accordance with that actuarial requirement, with the statutory requirements of Act 205.

The commission also reviews those actuarial reports for purposes of determining each municipality's eligibility to receive state pension aid and the proportion in which they'll be entitled to share.

Last year, that was $206 million that was distributed. So this is not a small amount of money. This is $206 million of state tax revenues that never actually passed through the General Assembly and the budget.

So that you have an idea of where that comes from, in the Tax Reform Code, which is -- okay -- Section 902. It imposes a tax on insurance companies doing business in Pennsylvania to pay a two percent tax on those premiums.

Now, if the municipal -- if the insurance company is headquartered outside of Pennsylvania, if it's what we call a foreign corporation, domiciled in some other state, that two percent tax does not go into the general fund.

It goes into a special fund, which is then used to support the volunteer fire relief associations and municipal pension plans. And it's been that way for quite a number of years.

The first act -- first statute that dealt with that was passed in the 1920's and it's more or less tracked consistently ever since.

The $206 million is utilized by those municipalities that receive it to allay their costs of providing municipal pensions and also to fund the administrative expenses that they incur in providing those municipal pensions.

We don't actually distribute the money. That's handled by the Auditor General's Office.

And if you watch, they'll do the -- they have the news releases every autumn, around October, saying we just sent this big check to your municipality.

The -- the state aid system which was adopted in 1984, effective in 1985, Act 205, was a major change from the old allocation system.

Before that aid was only available to police and fire pension, not to nonuniform or general employee pension plans.

And the allocation of state aid was based upon population, miles of paved road, and other totally irrelevant conditions which resulted in some municipalities receiving substantial amounts of money in excess of what they required and other municipalities to be severely shortchanged.

We're still dealing with that situation. We have a number of municipalities in Pennsylvania which were so overfunded under the old statutory scheme that they live now off the interest earned on those pension monies that they received from the state before 1985.

The interest alone is exceeding their full cost of providing pension benefits and administrative expenses, and it just continues to increase, and there's no indication that that will change in the near future.

We have other plans. Almost half of our plans receive their entire cost requirement from the state. In other words, there's no employee earned contribution at all.

I think last year it was 47 percent. It -- it hovers right in around the halfway point.

We have other plans that are substantially underfunded and have great employer contributions in addition to what they receive from the state.

The purpose of Act 205 was to gradually shift that. The idea was to get everybody to a zero balance. Those who were being overfunded would get less, those who were being underfunded would get more, and gradually it would all come out to a zero.

We're nowhere near that zero yet. In fact, the most recent study that was done by the Economy League of Southwestern Pennsylvania would indicate that about the same number of plans are underfunded as were in that same situation back in 1985.

So the -- while some of the individual players have shifted their status, the overall scheme has not.

Philadelphia, by the way, is not a part of the structure for the state aid. Philadelphia is limited to 25 percent of the total amount that can be paid out in state aid.

That sounds like a lot of money, but

if they were getting their unit value instead, they'd be more like 50 percent. So, yes, they have that many employees.

So if they actually got what -- if they were paid on the same ratio, the same basis, as every other municipality were, they'd receive about twice as much money as they do now, and everybody else would obviously then get a lot less. So -- but Philadelphia is in the mix, but they're in the mix on a fixed percentage basis.

That is -- that is a nutshell of the commission's work in regard to Act 205. Obviously, there's a lot more that could be addressed, but I'm trying to see if we can't just overview a few major points.

You should each have received a document with sort of a yellowish cover, fairly thin, Public Employee Retirement Commission, state seal in the middle, and it references that it was prepared for this House Finance Committee meeting. That provides some overview of what we do.

In addition, you will have received or you should have received a copy of our status report on local government pension plans dated from November of 2006 and a current version of our legislative update, legislative report, which shows the pending pension legislation, pending retirement legislation, and that which has been introduced in this particular session of the General Assembly.

Again, to walk back into who we are and where we came from, this commission was created by Act 66 of 1981.

We're made up of four legislative members, one from each caucus, and we also have five gubernatorial appointees. The gubernatorial appointees are required by statute to have skills and experience in the area of public pension.

Besides monitoring those pension plans that we do through Act 205, one of the other things we do and one of the things we were created to do back in 1981 is to provide an actuarial analysis of every piece of legislation affecting pensions before it receives second consideration in the house of origin.

That's our legislative function. That's one of the reasons why we're an independent commission as opposed to being purely an executive branch commission, because we have this dual function.

One is entirely under the executive, the regulation under Act 205, and this one, which is purely legislative, which is to provide guidance to the General Assembly on pension legislation.

The -- the first handout that I referenced, the small one, beginning on Page 10, we've outlined the legislative procedures that need to be followed in order for us to perform our function dealing with the General Assembly.

The statute has provided the commission with 20 legislative days from the date of first consideration or adoption of a floor amendment in order to prepare the actuarial report.

If we don't have it done in that much time, you're free to proceed with the second consideration.

But prior to that, you may not

proceed with your second consideration until after our actuarial study is done.

The more complex the issue, the longer it takes us to get that work done. I mean that sounds simple, but we move as fast as we can.

There's no question that we have historically come in well under the 20-legislative-day mark, and we do everything we possibly can to be as accommodating to the needs of the legislature as possible.

However, if you send us a very complicated piece of legislation, it can take -- we are not going to have it back to you the next day, no matter how hard we try. No matter how badly you want it. It can't be done.

Plus, it has to go before our commission in a public meeting held here in Harrisburg, which means we have to gather up our commissioners and get them into town.

And, normally, that's not a big problem. But the more lead time you can give us, especially on important issues, the better off we are.

The normal process is that we respond to requests for actuarial notes that come from leadership. That can be leadership of the general -- of the chamber. That can be a committee chair, whether it be majority or minority committee chair.

We're as accommodating as we can be. We have not -- and this is by agreement with the General Assembly. We do not act on a request that just comes from a member that has not been vetted and sent to us by leadership.

And that's a policy that was established in the past at the request of the leadership of the General Assembly because, for obvious reasons, they wanted to maintain some control over this.

Plus, there's a budgetary consideration in that. Our agency is not highly -- is not a heavily funded one.

Our total appropriation is about three quarters of a million dollars, and that covers everything, including the actuaries. So it gets a little bit tight sometimes.

We can't do an actuarial report on every piece of legislation that gets proposed.

We respond as rapidly as we possibly can. The actuarial notes that are prepared, as I said, are presented at a public meeting. The sponsor is always invited to attend and to participate. And we welcome those -- the participation of sponsors of legislation.

And we then proceed with issuance of an actuarial note and transmit the same to the General Assembly and to the Governor.

There's also a process that's been utilized which is a bit short of an actuarial note, and that's what we call an advisory note. And that's one that's normally done before any real consideration. It's usually while the bill is still in committee.

And it's a guidance type of a note. It is not run through the entire commission. It's not vetted in and -- and approved at a public meeting.

It is sent over, and it's just what it says, it's advisory only.

And the only other reports that we do are policy reports, and probably the most recent one that we've done, that some of you may be familiar with, because you're still trying to figure out what to do with that giant piece of paper that you have filling up your office, was a report on divestment legislation.

It was sent out to everybody last fall. That was triggered by the request of the commission chair. Even though investments are not really within the scope of the commission's general purview, because it doesn't have anything to do with actuarial status, the impact on funding generally was one that the chairman wanted to address.

And we did put together a policy report, a special report on divestment legislation, that was issued. It was adopted the end of October, and some of you may be familiar with it.

I'm sure no one has read it. And I don't blame you. But that is another type of report that we do.

The -- the legislative function, again, goes to every single piece of legislation which deals with pensions in any way.

There is another twist, by the way. If you'll take a look at the legislative report that was handed out, I want you to note something here.

The very first bill on the first page, which was House Bill 126, was a PSERS and SERS amendment to expand the employer contribution floor rates, mandatory contribution rates.

And you'll see that there was --there were two actuarial notes done by the commission. Both of them issued on March 22nd of 2007.

One was the actuary -- was for Printer's Number 152 and one was for an amendment. That's the A number that you see. Amendment 174.

The reason I want to point that out to you is because we had one piece of legislation actually pass last year; and if you'll look on Page 7 of that same report, at the top of that page, you will see a reference to House Bill 876.

876 was the increase of the SERS floor to four percent. That was adopted and

signed by the Governor as Act 8 of 2007.

But what you don't see in that right-hand column -- and we have them highlighted every time -- is an actuarial note. And the reason why you don't see an actuarial note is because this was exact -- exactly the same issue that was addressed in Amendment 174 to House Bill 126.

So instead what you see is the commission letter. The commission letter says we've addressed this issue in that actuarial report and simply cross reference to it and say that this bill doesn't have any additional impact beyond that.

So there was an actuarial note, in fact, done to this bill, to House Bill 876. It was just done by cross reference to 126.

And you're going to sit here and go, how am I supposed to keep track of that? Well, one advantage to this is that this is all on -- I hate to say this, but I actually like it sometimes. This is all on the website.

We maintain it on SERS's website, but we maintain it, and you access it through the

Public Employee Retirement site, a legislative listing that includes all of the pension legislation, pension-related legislation that's introduced in any given session.

In each one of those, you'll see this same concise history and status. If you click on the highlighted commission letter or actuarial note, you'll bring up that commission letter or actuarial note.

They're all there. Every single one of them can be found right on the website. And while I don't normally go along with high tech a lot, that's one that seems to work.

The one other thing that's on the 'net, oh, besides all of our reports, status reports, annual reports, but the other thing that's on the 'net that I would like to call your attention to is on DCED's website.

The Department -- Department of Community and Economic Development publishes a municipal pension handbook that's listed in their publications section.

We used to do this directly through the commission, and our last version needed an update at the same time that DCED was looking to update theirs. So we wrote theirs, and it's on their website.

It's an outline of municipal pension statutes, and it's only an outline. It's -- there is no way to provide a brief explanation of the municipal pension status in Pennsylvania because there's no system.

We have statutes for police. We have a borough code provision. We have a second class township code provision. We have a first class township code provision. We have Act 600, which applies to boroughs and townships with three or more police officers. We have the third class city code. We have the third class optional charter law. We have the home rule and optional charter law. We have the second city code and second class day city code and the first class city code, and with regard to Pittsburgh and Philadelphia, because of their special statutes, you have to actually access their own individual local ordinances which take on the effect of state law. That's just the police.

For fire, we have cities, third class cities. We have third class city optional plans. We have the second and second class day cities. We have the first class cities.

And for nonuniform we have anything you want. There's no statutory structure for nonuniform employees. It's whatever the local government creates.

There is no statutory structure for fire departments in boroughs or townships. And, yes, we do have paid fire departments in boroughs and townships. But there's no structure as to what that benefit has to be.

So while you do have some statutory scheme for certain plans, you have absolutely none at all for others, and it's entirely a matter of local control. And the only way to find out what's there is to go to that specific municipality and look at the ordinance.

While you're looking at ordinances, you also have to look at collective bargaining agreements because Pennsylvania treats pension benefits under the provisions of Article 3, Section 26 of the Pennsylvania Constitution, which is what you call the contract clause.

So if you've agreed to provide a

benefit, even if your statute doesn't do it, you still are bound to provide that benefit and so you also have to look at the individual contracts, statewide, in each municipality.

(Sound made by sound system) I feel the same way. And there is no true method to the madness.

There is -- you know, there are some statutes that apply to everybody. Act 205, the funding requirement, applies to everybody. The Pension Forfeiture Act, Public Employee Pension Forfeiture Act, applies to everybody.

But the vast majority of our statutes don't apply to everybody. They vary depending upon the nature -- the class of the municipality, what the specific municipality has elected to do within the statute governing that class, and also, of course, with boroughs and townships, how big a police department you have.

So to sit here and say I'm going to provide you with a one-hour summary of the pension system in Pennsylvania would be a fabrication on my part.

First of all, because there really is no system. It's way too individual for that. There's a funding mechanism which is consistent, but that's about it.

And beyond that it's a matter of wading one at a time through each individual plan. And this is one reason why your actuarial reports can be so different.

We have been working on one -- I'll give you a perfect example. We've been working on widows' benefit forfeiture provisions. What we call the remarriage penalty. I used to refer to it as the living-in-sin clause.

A lot of our pension plans, our pension statues provide that a surviving spouse stops receiving her pension benefit if she remarries.

The trouble is, is that was done one municipality at a time. So in order to fix the problem, you have to go into each individual pension statute one at a time and fix it.

We've been working on this since the mid '90s and we still have a couple. In fact, our meeting in -- in March is going to address two of them. And we're still trying to get rid of the remarriage penalties.

It should be simple. But it's not. And the reason why it's not is because every plan's different and you have to deal with it one plan at a time.

And it does result, it has resulted in people being given improper advice in the past. There was a widow, I recall, out in Pittsburgh who mistakenly thought that she could remarry because the General Assembly had repealed the remarriage penalty, but they'd only re --repealed the remarriage penalty in Act 600 and not in the second class.

Hey, we repealed it for Act 600. We repealed it for the third class cities. But we hadn't repealed it for the second class cities, and she's a second class city, so she remarried and lost her pension.

With advice, you know. So -- from her representative. Actually from her state senator. I wouldn't want -- I wouldn't want to suggest a representative would make that error.

But it's easy to make that kind of mistake. And it's easy to make that kind of mistake because of the complexity of the -- of what's out there. And I don't have any easy solutions for any of these things.

But you wanted to know what it is we do for a living, we try to keep that stuff sorted out and -- so we give the General Assembly the right advice when we're dealing with legislative proposals.

And we also have, and still do, and will continue to do in the future, assist in the drafting of legislation where it's been requested.

So we're entirely out there saying, no, that's a terrible idea. Sometimes we're in there saying, this is a great idea whose time has come. Let's do it.

I know. It's awful. Now, that I've scared you all to death, any questions?

CHAIRMAN LEVDANSKY: Thank you, Mr. McAneny. Before I ask members if there are questions, we've been joined by a few members that came in late. Representative Josh Shapiro from Montgomery County;

Representative Jaret Gibbons from Lawrence County; Representative Dan Frankel from Pittsburgh and Allegheny County; Representative Brian Ellis from Butler County.

With that, do the members have any questions?

Representative Frankel.

REPRESENTATIVE FRANKEL: Thank you. And good afternoon.

You -- I mean you've just gone through this report and I have had a chance to see this in the past. I mean there's so many issues that we need to deal with and I think you identified some of them, particularly the extraordinary fragmentation that we have in Pennsylvania with respect to the number of local government pension plans.

I mean I look at this, 3200 almost, and I've been told that that represents 25 percent of all the local government pension plans in the entire country.

DIRECTOR McANENY: Well, that's about correct. Actually it's probably a little bit more than 25 percent.

REPRESENTATIVE FRANKEL: Okay.

DIRECTOR McANENY: It's somewhere between 25 percent and a third and every year we add about 30 more. It's called --

REPRESENTATIVE FRANKEL: It's great to be number one.

DIRECTOR McANENY: Yeah, it is.

REPRESENTATIVE FRANKEL: But somehow not that.

And the other thing in terms of, you know, looking at the administrative costs, I mean it's just incredible. I mean the number of plans where you have fewer than ten members, active members, participants, I mean just extraordinary.

You have a graph here that shows some of these plans have administrative costs of, what 14, $1500 per -- per participant.

I mean if you're --

DIRECTOR McANENY: Well --

REPRESENTATIVE FRANKEL: If you're operating -- I mean at the state level, what are the costs, the administrative costs per -- per active participant?

DIRECTOR McANENY: A couple hundred.

REPRESENTATIVE FRANKEL: A couple hundred.

DIRECTOR McANENY: I don't have the current number on it.

UNIDENTIFIED McANENY ASSISTANT: 197.

DIRECTOR McANENY: 197.

REPRESENTATIVE FRANKEL: 197. On some of these plans.

DIRECTOR McANENY: For the past year, yes. That's not the fault of the administrators of those plans. That's the nature of the beast.

The smaller the fund that you're working with -- if I have a three-person pension plan, I'm going to incur certain costs. And there's only three people to divide that among.

And if I have a hundred people, I'm going to have pretty much the same administrative costs. I just have a lot more people to split it up with.

REPRESENTATIVE FRANKEL: Right. You don't need to --

DIRECTOR McANENY: So, you know, it's -- it is just the nature of the beast.

The more fragmented it is, the smaller it is, automatically the higher the costs.

REPRESENTATIVE FRANKEL: That certainly points to a need --

DIRECTOR McANENY: Yeah.

REPRESENTATIVE FRANKEL: -- for some consolidation ultimately. I mean I think if the public and taxpayers understood this, as I think, you know, sometimes listening to this information, even our eyes glaze over. But it is really quite extraordinary

The other -- the other -- one of the other issues I wanted to touch on, which has perplexed me, because under -- the state aid under Act 205, one of the problems that we see -- and I know in the city of Pittsburgh, which I represent, is in Act 47, two oversight boards.

One of our principal problems is our unfunded pension liability. We have received benefits under state aid through Act 205 over the years, which has gone down dramatically over a period of time.

And one of the problems we have is we try and restructure our city, and I think this has been -- and it's reflected also in other cities, that the -- or in 47, on the verge of 47, is, you know, as we restructure our city governments and expenditures, we downsize significantly. You know, we try and streamline our operations, and you reduce the number of employees, and under the state aid formula you get a whammy, which is less state aid because the formula depends on the number of active employees.

So it's kind of a whipsaw effect. While you solve one problem, you exacerbate another problem and, again, this -- I mean this is part of the law and I think something that we -- that we need to take a look at.

But as municipalities try and exercise control over their own expenditures, and they have this lingering problem, which I don't think can be resolved internally at this point, of -- of dramatically unfunded pension liability systems, being penalized under the state aid formula for making fiscally responsible decisions in terms of reducing staffing, is -- is problematic.

Maybe you can comment on that.

DIRECTOR McANENY: Pittsburgh.

REPRESENTATIVE FRANKEL: I don't think it's just a Pittsburgh problem.

DIRECTOR McANENY: Well, actually Pittsburgh's biggest problem is it has the only 20-plus year no call bond in the country.

You can find some places that do a five-year no call on a government bond. Probably 50 percent of them. When you get to about ten years, you might find, oh, 20 percent that are still doing it.

When you get to 20, you'll find one. And the fact that they issued that bond at a fairly high interest rate and now are stuck with it is a bigger problem for Pittsburgh than the reduction in the size of its workforce.

But every time you reduce the size of your workforce, you also reduce your pension costs. I mean they're not having future pension obligations on behalf of employees that they're not hiring.

So whenever I say, well, I'm being penalized for reducing the size of my department, you are, in fact, receiving less state aid because your -- but your costs are also coming down.

So I might disagree with you about whether or not that's a penalty for that purpose. Or being punished for that purpose.

Does it have that impact? Yes. Any time you reduce the size of your workforce, you also reduce the amount of state aid because you have fewer units that are now being calculated in.

But the cause of the fiscal distress in Pittsburgh goes way beyond just that.

REPRESENTATIVE FRANKEL: Oh, no. I'm just looking at one segment. I understand that.

DIRECTOR McANENY: I know. That's like whoa (sound).

REPRESENTATIVE FRANKEL: I certainly understand that it's much more complicated.

DIRECTOR McANENY: Yeah.

REPRESENTATIVE FRANKEL: But this is an issue that I think confronts other cities as well, because that -- that big chunk of money out there, when you look at the city's issues, and you've identified one of them, I mean the city's debt and the city's unfunded pension liabilities, you know, the cost of health care, et cetera, I mean it's many and very difficult to wrestle with for lots of cities across Pennsylvania.

And this -- the formula is something that I think maybe we ought to at least look into in terms of a way to adjust so as these cities try to downsize appropriately they're -- they can still address the pension liability.

DIRECTOR McANENY: I'm not disagreeing that there could be some changes to the allocation formula that might benefit cities.

That's a political determination, however, and not one that our commission would be involved in.

I do know that there will be some substantial opposition --

REPRESENTATIVE FRANKEL: Sure.

DIRECTOR McANENY: -- from the municipalities that will now get less. Yeah. And they've frequently -- I think the term that is always bandied about is bail out. And you want the munic -- you want the townships and boroughs to bail out the cities.

I don't necessarily have a fundamental problem with having state aid used to bail out, if you want to use that term, to pay where the need is.

Okay. In fact, I think it's a good idea to have state aid go to where the need is. As opposed to our current system where some municipalities don't pay anything at all. Some employees pay nothing at all.

REPRESENTATIVE FRANKEL: Well, let me ask. This is the last -- last question and comment.

I mean isn't it true under Act 205 that some municipalities that really do not have truly distressed pension liability were able to access state aid under Act 205 by eliminating employee contributions or increasing benefits?

DIRECTOR McANENY: There have -- there have been situations where they not so much access state aid, because if you don't get state aid in the first place, you're pretty much stuck. But they've been able to increase.

The mechanism, which admittedly I used to be involved in, the mechanism was -- was where you already get state aid, can I now maximize how much state aid I'm going to receive?

Surprisingly enough, if I've reached the point in my funding status where I no longer get state aid, it's extremely difficult for that to get started up again.

So it's not as easy to manipulate. And, yeah, it can be done and it has been done. I'm sure it's been done.

REPRESENTATIVE FRANKEL: Thank you.

Thank you, Mr. Chairman.

CHAIRMAN LEVDANSKY: Representative Ellis.

REPRESENTATIVE ELLIS: Thank you, Mr. Chairman.

If I could just follow up real quickly. In the status report on local government pensions, I noticed many of the municipalities are showing several, some of them up to five, six different pension plans.

DIRECTOR McANENY: Correct.

REPRESENTATIVE ELLIS: Okay. How does that -- can you explain to me real quick just the basics, why, like the city of Butler, which I represent, has three pension plans, one very well funded, two underfunded?

DIRECTOR McANENY: Okay. If you take a look on Page 50 of the plan, of the book, of this report that you're referring to, you'll see, oh, almost to the bottom of the first grouping, city of Butler. You see a Butler city fire plan.

REPRESENTATIVE ELLIS: Okay.

DIRECTOR McANENY: Okay? You take it across. It's an 84 percent fund ratio. That's pretty good.

The next one down is the Butler city nonuniform. That's the N. See the letter N right by plan type?

REPRESENTATIVE ELLIS: Right.

DIRECTOR McANENY: That's a 123 percent fund ratio. That's doing real good.

Then you have the Butler city police plan, which is the P, and there you're showing a 96 percent, which is fairly close to a hundred. I mean nobody just sits at a hundred and stays there. There's got to be fluctuation some -- from year to year.

So those plans are actually doing pretty well. Then you have your Butler city redevelopment authority plan, which is a one-member plan, and I believe that's all you have, is the four. I don't know that you have a five.

REPRESENTATIVE ELLIS: No. I was -- I was just using that number.

DIRECTOR McANENY: No. I was just saying I think four is the correct number for the city, and that's why.

REPRESENTATIVE ELLIS: Are there other cities that consolidate those into -- to one pension or retirement fund --

DIRECTOR McANENY: No.

REPRESENTATIVE ELLIS: Or is -- are they mandated to be separate?

DIRECTOR McANENY: The only one -- each one has a separate governing plan for police officers, for firefighters, and for nonuniform, generally speaking.

Some of them have multiples.

Philadelphia has what they call the 67 plan, which is the old plan. 67 references the year of its adoption. And the 87 plan, which is their more current one. But there are still some people working under the old plan. And -- so they report two different plan structures.

They have the same thing with their fire department. They have two plans there. And then they have their nonuniform plan.

Now, they consolidate all of them into a single fund for purposes of investment and administration. But the benefit structures are all different. So they're really different funds. They're really different plans.

Yeah, most municipalities, and most cities have consolidated for administration and investment into one big plan.

But they're still different plans because the benefit structures are different. If you're in a third class city, there's a third class city code structure that you have to follow for your police department. There's a structure you have to follow for your fire department. Those are statutory.

There is no structure you have to follow for your nonuniform plan, so you do what you want.

And, you know, so they are all going to be different in their structure. Two of them because of the statute and one of them because you want it to be.

So you can't really put them all into one plan because they're all different. They're not like a state employees retirement system where everybody is on the same plan with the exception of class of service multipliers.

This is a whole lot more than just class of service multipliers. There is -- there is across the board in terms of terms so...

REPRESENTATIVE ELLIS: Have you seen a movement throughout the Commonwealth of the creation -- you said there are a lot of creation of new plans. Are we seeing a trend toward the defined contribution versus a defined benefit plan?

DIRECTOR McANENY: No. No, there has

not been such a trend.

There are in the -- in the one- and two-person plans, the general rule is they're usually a DC plan, a defined contribution plan.

Once you start getting into larger groups, no, they're defined benefits. Say from three on up, they're very rarely a defined contribution plan.

REPRESENTATIVE ELLIS: Thank you very much, Mr. Chairman.

CHAIRMAN LEVDANSKY: Representative Denlinger.

REPRESENTATIVE DENLINGER: Thank you, Mr. Chairman.

Thank you for your testimony. If I missed it in your earlier remarks, Mr. McAneny, I apologize.

But I'm wondering what are the provisions for third-party auditing that would oversee these plans? Does that happen at the -- at the local level or does that happen in your agency?

DIRECTOR McANENY: No. The Auditor General's Office does the audits of all municipal pension plans.

They do so under both the specific provisions of Act 205, which direct that they have the audit authority, and under the Fiscal Code, Section 402, which gives the Auditor General the authority to audit any recipient of state aid monies.

So those are -- that's how the audits are conducted.

REPRESENTATIVE DENLINGER: And -- and in relation to that, I'm wondering -- Representative Frankel got into the whole issue on funding liability.

Obviously, within the accounting provision under GAAP, corporations in the private sector have been pushed to do a much better job of reporting their liabilities and, in fact, taking steps toward funding them.

At the governmental level, the provisions of GASB Statement 45 are pushing municipalities in the same direction.

And I'm wondering, are you starting to see any effect of that or hearing of steps by municipalities to start to comply with governmental standards of a more national nature?

DIRECTOR McANENY: All right. There are two types of GASB standards that we want to talk about.

One is the standard for the reporting of pension liabilities, and I think that has been, across the board, accepted by municipalities and they're all following it. I haven't seen any indication that they're not.

The other one is the more current issue of OPEB's, the other post-employment benefits. Probably the most common that everybody thinks about is post-retirement medical benefits.

And that is -- well, that's been a declaration of war as far as I can tell. We have entire states that have specifically asserted their intention not -- to not comply with GASB, that they feel that GASB has overstepped its authority in issuing those things.

Some places are trying to comply. Other places are absolutely refusing to do so.

And I don't have an answer for that. Here in Pennsylvania, it's early and we haven't seen any of the OPEB reportings yet. We'll find out what the intentions are when they start being filed, and that will start landing this year.

So at this point in time I haven't heard flat out that they are or aren't going to comply.

I mean it's not like I've heard, well, the Governor's Office of Administration has said, forget it, we don't have to do it, we're not going to do it. Or like the city of Philadelphia has said such a thing. In fact, I read that Philadelphia is preparing to release it's OPEB liabilities.

So it's part of -- and that's one of the noises they were making as part of their -- I'm not sure if you heard. They're talking about another pension bond, refinance their prior liabilities and help pay off all this stuff at one time.

But, you know, how that is going to fall from one place to another, you know, a lot of places don't have post-retirement medicals. That tends to be more of a big employers/small employers issue.

So we'll see where it comes. It's too early for me to tell you what Pennsylvania is going to do.

REPRESENTATIVE DENLINGER: Very good. I appreciate that answer.

And, Mr. Chairman, if I could recommend that over the next year and beyond, this committee may want to watch that situation very closely to see what our municipalities are doing with regard to this, properly accounting for it, and hopefully funding those outstanding liabilities.

CHAIRMAN LEVDANSKY: Thank you.

Any other members with questions?

Representative Seip.

REPRESENTATIVE SEIP: Thank you, Mr. Chairman. I have a very specific question I think maybe you may be able to help me out with.

I have a third class city in my district. Their police officers were doing some details, some extra work, I guess, for the school district, providing security.

And they had -- the school district had to stop using them because it was reported that that was affecting their -- their pension liabilities and increasing the pension of the officers.

Is that -- does that sound accurate? Does that -- did I hear that right?

DIRECTOR McANENY: All right.

REPRESENTATIVE SEIP: Because it was unfortunate, because I think the level of security they were getting from the trained police were probably -- it was better than the nontrained security people that they had to go with then.

DIRECTOR McANENY: Yeah. And I'm not necessarily going to disagree with you. In fact, I agree with you a hundred percent on the issue of the level of security.

On the issue of including that compensation in the pension, I'm going to tell you that the third class city code specifically provides that overtime pay is not to be included in the calculation for pensions, in the income calculation for pensions.

That's what the statute says. But this is Pennsylvania, and the local practice may very well be otherwise.

And if that is the case, then you run into your constitutional contract clause problem, and the Supreme Court has shown a lack of interest in what the statute says if, in fact, they've been -- both sides dealing with the issue in a specific fashion and including that money in the pension, then it's included, and there's ways to get out of it but they're all projected into the future.

REPRESENTATIVE SEIP: The third class city code, am I right, did I hear that that goes back to like 1921 or something like that?

DIRECTOR McANENY: Well, its first version does. But the provision that specifically deals with not including overtime pay in the calculation of the pension goes back to, oh, early to mid '80s. And I don't have the reference right in front of me.

But that's about the time frame. Because it followed up -- there was a statutory follow-up on a court case that said that overtime is not to be included under Act 600.

And since the third class city code statute didn't address it, instead of waiting for a court case, they addressed it. The General Assembly specifically put that in the code.

Yeah, so it's been there for a while. Twenty-some years, but that doesn't mean anybody is actually obeying it.

REPRESENTATIVE SEIP: Okay. Thank you.

Thank you, Mr. Chairman.

CHAIRMAN LEVDANSKY: Thank you.

Mr. McAneny, I do have a couple questions. In terms of your legislative procedures, you note that you get -- you do actuarial notes in cases where leadership of the House and Senate request such notes to be performed.

DIRECTOR McANENY: That's correct.

CHAIRMAN LEVDANSKY: You also note, I think, the Appropriations Committee chair --

DIRECTOR McANENY: Yes.

CHAIRMAN LEVDANSKY: -- can request?

Did you also point out that the committee chair in either chamber shall notify the commission upon reporting the bill and -- and request an actuarial note?

From my perspective, I would, as a member of this committee, before I would vote on any pension-related bill, I would find it very helpful and instructive to have an actuarial note prior to the bill being voted in committee.

Does or would the commission be willing to -- to do an actuarial note in the case of the Finance Committee, if you have the chair of the Finance Committee request such a note to be done?

DIRECTOR McANENY: Yes, sir. That is not a problem.

CHAIRMAN LEVDANSKY: Okay.

DIRECTOR McANENY: And I don't -- I want to take a look at the document again. We do it at the request of the chair of any committee.

CHAIRMAN LEVDANSKY: Okay.

DIRECTOR McANENY: Okay? And what we request is that the committee look at the specific legislation and decide if this is something where there's a real interest in moving before they request a note though, because, if we do a note on every piece of pension legislation, to give you an example, how many COLA proposals do we have right now? Nine? Or is it more than that? Last time I looked it was nine, but I'm not counting.

And if we do an actuarial note on each one of those -- unless, of course, you wish to substantially increase our budget.

CHAIRMAN LEVDANSKY: Well, I'm not suggesting that, and I think you're probably also cognizant of the fact that none of the bills have moved from this committee.

DIRECTOR McANENY: I know that.

CHAIRMAN LEVDANSKY: But if -- you know, I'm just asking that, because, you know, rather than having it done --

DIRECTOR McANENY: Sure.

CHAIRMAN LEVDANSKY: -- after it comes out of committee, before second consideration, you know, my preference would be that if -- if we do decide, you know, to consider a bill, I'd -- I'd like to have the benefit of the actuarial note before we vote on it.

DIRECTOR McANENY: We can do it. And we have done it in the past, and we will continue to do it. And if you request the actuarial note, we will proceed with preparing the same.

CHAIRMAN LEVDANSKY: Okay.

DIRECTOR McANENY: All we really need is a bill. What you -- what you -- what we do have difficulty with are the people that contact us to have us do a -- an actuarial note on a piece of legislation which does not presently exist.

And without a bill, or even an amendment number, that's pretty hard to do, because you have to have something to give the actuary for them to take a look at just what we think it might say when it finally comes out, that's a little tough.

CHAIRMAN LEVDANSKY: I understand.

Just -- just one other question. From your perspective, and in your opinion, what's the most important issue facing our Pennsylvania public employee pension systems?

DIRECTOR McANENY: State or local? Because they're totally different.

CHAIRMAN LEVDANSKY: Both.

DIRECTOR McANENY: You can't match -- if you're going to say both, then the only issue that can be both is the funding.

CHAIRMAN LEVDANSKY: Either.

DIRECTOR McANENY: If you're going to say separately, at the local level, providing some consistency at the local level is probably the most important thing.

I don't mean to be insulting. I refer to it as taking away their shovels on the ground that if you're in a hole and you want to stop, the first thing you do is you stop digging and we -- there's an indication that certain municipalities are incapable of that particular function.

So possibly to establish some -- we have state laws. I mean we have lots of state laws. And we don't have a pension police, and I don't want to be one.

But that's the problem, is we have a lot of state laws, but they're not necessarily followed. And there's really not anything that anybody here at the state level is doing about that or can do about it.

Nobody has that authority. And even if you had the authority, who the heck has the capacity to go out and police, you know, 3,000 municipalities.

So, you know, there's got to be some way to put a real system together and, you know, we have had our proposals in the past. And I'm not here to pitch any of them today. I don't want to come in here as an advocate on behalf of a solution.

But to find some way to provide a level of -- a certain degree of consistency, consistency in funding and consistency in the management of the plan, the administration of the plan.

CHAIRMAN LEVDANSKY: And how about for our state systems, our state retirement?

DIRECTOR McANENY: The state systems, there's -- really the only issue that exists at the state level, the one that drives me the craziest and it probably goes together with the issue on those COLA's but it's a funding issue.

We don't fund for COLA's. Now, everybody expects one. Pick up today's Harrisburg Patriot. There's a letter to the editor. I've been retired for eight years and I've only had two COLA's.

And -- and I realize there's no promise to anyone that there will be a post-retirement adjustment. But people have come to expect it, and they certainly lobby for it, and their organizations lobby for it.

And they'll say things like, well, the money is there. It's in the pension fund.

No, it's not. There isn't a penny in those pension plans for COLA's. The money that's in the pension plans has been contributed based upon the cost of the existing plan. It's to fund the existing benefit.

We don't fund for a cost-of-living increase. If we're going to keep doing cost-of-living increases every X number of years, or whatever, then we should advance fund.

We should plan for it right now. If

you decide to pass a cost-of-living increase, not one penny of the money that's in either one of the state systems gets used for that.

What does get used for it is new money. Well, who does the new money come from? The taxpayers. The employers. And you have to amortize it then over a period of years.

If you do a COLA, you got to put more money in. The state is going to contribute more to SERS. The state and the schools are going to contribute more to PSERS.

It doesn't increase the employee contribution. They are fixed. So if you're going to have COLA's, prefund.

CHAIRMAN LEVDANSKY: And in that regard, could -- my understanding is that we're one of the few states that permits the state and public school employees to withdraw their contribution at retirement.

If we want to do COLA's, would it, in your judgment, be appropriate to consider requiring retirees to leave some of their contribution in the system to help fund those future COLA's?

DIRECTOR McANENY: Our mechanism for withdrawal of contributions at the time of retirement is very employee friendly.

They do not -- the amount that they get back is more than what they lose in the reduction, the actuarial reduction. Okay? It's a real bargain. That's why you see everybody do it.

Do I think that if you're going to have COLA's, tell somebody that if they withdraw their contributions, you don't get a COLA? That's an administrative issue that would have to be addressed by the systems.

I'm not sure that's possible to do it on a one-on-one basis that way.

CHAIRMAN LEVDANSKY: I'm not --

DIRECTOR McANENY: But I think it's fair to say across the board no more withdrawals of contributions at the time of retirement and we're going -- if that money was then earmarked for the funding of future COLA's, then it would fund COLA's.

But if you don't use it to fund -- but if the statute doesn't specifically require that that happen, then it's still going to be the same situation, which is that money is simply going to go into the pot, it will reduce the employer contribution now, and when the COLA's pass you still have this big bump.

Always remember that the big hit, the big 2012 jump that everybody is fearful of is a direct result of the General Assembly's refusal to go from one to five percent, because that was too big a jump, and so we stayed at one and zeros, and that way -- you know, they pushed it off into the future.

You can kick the can down the road some more but eventually you get to a dead end.

And, yeah, if you're going to fund a COLA, there are ways you could utilize that money to do that. There are also additional contributions that could be made to fund something like that.

But from an actuarial perspective, if it's going to be done, and it's been done and there's a history of it being done, we may as well recognize that it's going to continue to be done, quit pretending that it's -- well, it's ad hoc and we don't know if we're really going to do it.

Yeah, we are. At some point. I don't know when. But some day we will. It may not be until 2015. But at some point there's going to be another one.

If you're going to do that, fund for it. It's not really a complicated issue. It's sort of like if you're going to -- you have two ways of doing it. You can either take out the mortgage and buy it or you can save the money in advance and pay for it.

I'm suggesting we save the money in advance instead of just taking out the mortgage and paying it off. So...

CHAIRMAN LEVDANSKY: Thank you.

Representative Sainato.

REPRESENTATIVE SAINATO: I just want to follow up on Chairman Levdansky's line.

I've heard a rumor -- or this goes back to -- years, when it came to COLA's, and you're saying that you cannot use the money in the system to pay for a COLA, is that a law? Is that a federal law? Is it -- that question comes up all the time.

DIRECTOR McANENY: Okay.

REPRESENTATIVE SAINATO: Is the money in the system? Was the federal government saying you cannot do that?

DIRECTOR McANENY: The federal government has nothing to do with it.

REPRESENTATIVE SAINATO: Okay.

DIRECTOR McANENY: The money that's shown, when you look at an actuarial valuation report for SERS or for PSERS, the dollars that you're looking at are projected based upon no change in the existing plan.

They don't anticipate, there's no assumption that says there's going to be this benefit boost in the future. A COLA.

Therefore, whenever there's a COLA, your funding all of a sudden drops. If I pay out -- if I've got a fund of a half million dollars and I pay out a hundred thousand dollars, I now only have $400,000 but I still have $500,000 worth of debt.

What do I do? I had an obligation to pay five. I had the five. Everything was wonderful. Now, I'm fully -- now I'm a hundred less. What do I do with that? I have to throw more money in in order to catch up.

Now, that's what I mean. It's not a case of -- that we have this vast surplus, because there is no vast surplus and an actuary will tell you that there never is a vast surplus.

The old story of the actuaries, where they're playing golf and the one hits to the left side of the green and the other hits to the right side of the green, and they shook each other's hand because together they got a hole in one.

Okay? Because they don't hit directly on. They're coming up with estimates, and they're projecting it over, in the case of a governmental plan, forever.

They're looking at 40 years, 60-year futures, and saying this is how much you have to put in today, assuming all of these things being equal, in order to keep this level out into the future forever.

There's huge variations in reality from year to year. It's the long-term view that comes out correctly. Not the short term.

So if in the 1990s, because there's been a big kick in the stock markets, all of a sudden I've got this big, quote/unquote, surplus in my plan, that's not a surplus. That's the actuarial gain that's there today to pay off the future actuarial loss when there's an adjustment in the market and everything keeps coming out again.

They're projecting into the future. They assume there's going to be good years and bad years. If -- when there's a good year -- you're allowed to smack me if I go too fast -- when there's a good year, you don't take that money out. When there's a -- any more than when there's a bad year you have to reach into your pocket and put the whole thing in right now.

You're going to have years when the earnings exceed what you expected and you'll have a surplus on paper, and you're going to have other years where you don't earn that much and you'll have a loss on paper and the loss and the gain outbalance -- balance each other out and it's working just fine over a long-term projection.

But there's an immediacy issue that arises. You'll see a situation where you have a couple of good years and the plan looks like it's got this big surplus in it so everybody does an Act 9. You know?

And then immediately thereafter you have the market correction that everybody -- whether it was going to be that intense or not, you have 9/11 in there that nobody anticipated, but, sure, there's a market correction and things come back down again.

That's not unanticipated by the actuary when he was determining what money should be going into the plan.

You can't take contribution holidays, which, thank God, we now appear to have legislatively -- legislatively corrected. You can't have times with saying, well, we don't have to put any money in this year.

Well, if you don't put the money in this year, you're going to have put twice as much in next year. And if you pay money out in a COLA that you were saving to pay future benefits, then you're going to have to fund those future benefits by additional contributions.

That's what I mean when I say the money to pay for the COLA isn't in there right now.

There's cash in there. If you have $500,000 in the bank and you want to go out and buy, you know, a yacht and you drop a hundred thousand dollars on it, that doesn't mean that you couldn't do it.

But if you really need to have that $500,000 in there because of future liabilities, you're going to have to pour a lot more money into that bank account again to rebuild the fund.

It's not going to do it on its own.

REPRESENTATIVE SAINATO: Okay. Just one quick.

So the COLA's, every COLA we've done in the past, we've done an appropriation for it. Is that correct?

DIRECTOR McANENY: Every COLA that has been done in the past has been paid for from general fund monies, either at the state or at the school district level, yes.

REPRESENTATIVE SAINATO: Okay. Thank

you, Mr. Chairman.

Thank you.

CHAIRMAN LEVDANSKY: Representative Boyd?

REPRESENTATIVE BOYD: I was good to go until that last comment and I want to clarify. I want to make sure I understand what you're saying.

When a cost-of-living adjustment for a current retiree is passed, the benefit enhancement, those dollar amounts that are not within the actuarial analysis needs to be additional revenue kicked in?

DIRECTOR McANENY: That's correct.

REPRESENTATIVE BOYD: And that revenue is kicked in by?

DIRECTOR McANENY: Taxpayers.

REPRESENTATIVE BOYD: Okay. In the year they're passed or -- in the year that they're passed or spread out over a period of time?

DIRECTOR McANENY: Generally spread over a period of time. We amortize it like you were paying off a mortgage.

REPRESENTATIVE BOYD: But they

continue to accrue?

DIRECTOR McANENY: Oh, yeah. You pay it off with interest. So that's -- you know, if you had the money to pay for it today, which actuarially you never do, but you pay it off over a period of time and you pay it off with interest.

So, yeah, we --

REPRESENTATIVE BOYD: Okay.

DIRECTOR McANENY: It's more than just the straight dollar-for-dollar correction. It's -- you have an interest adjustment in there as well.

REPRESENTATIVE BOYD: When a COLA is approved, passed, do those -- is there a direct analysis of what those specific costs are attached to that piece of legislation, like a fiscal note for a standard piece of legislation, is there an actuarial note?

DIRECTOR McANENY: There's an actuarial note done, yes, and it does advise of the cost.

REPRESENTATIVE BOYD: And that actuarial note will assume what year -- how many year amortization?

DIRECTOR McANENY: Usually ten. Sometimes twenty. Depending upon the legislation. You have had -- we have had actuarial -- we have had -- we have had COLA statutes which have provided for the amortization time period. So we have to use whatever legislation calls for.

REPRESENTATIVE BOYD: I guess the question I'm trying to get at is you really don't know what the cost is because you don't know how long those employees are going to live.

DIRECTOR McANENY: Okay.

REPRESENTATIVE BOYD: So how do you know what the cost of that specific COLA is to be amortized through 20 years? How can you fix that in a ten-year period of time --

DIRECTOR McANENY: Okay.

REPRESENTATIVE BOYD: -- when everybody's benefit is higher?

DIRECTOR McANENY: You have an actuarial analysis which calculates the projected life expectancies of the individuals.

One of the things the actuaries look

at is the demographics of the population involved, including their age and their life expectancies.

So, yeah, the cost, when you're determining how much you're going to have to pay off, is not year to year, this is how much we had to pay out in a check this year for COLA's. That isn't how you pay it off.

You pay it off on the basis of this is how much as a lump we need to pay off the entire future cost of this cost-of-living increase and this is the time frame in which you have to pay it off, and you pay it off in equal installments each year.

REPRESENTATIVE BOYD: But shouldn't at the very least those -- those time periods be the same?

DIRECTOR McANENY: No. Should the time period be the same as the life expectancy of the individual most likely to live the longest? No, it shouldn't be that long.

It should be, as it is right now, it should be averaged out to it's -- a workable time frame.

You can't utilize the life expectancy

of those persons able to receive the COLA because you're going to have people in there, you know, with 20, 25, 30 more years of their life expectancy. It's not actuarially sound to utilize a time period that long --

REPRESENTATIVE BOYD: But if I understand --

DIRECTOR McANENY: -- in a projection.

REPRESENTATIVE BOYD: But if I understand the actuarial analysis correctly, they will project some people who receive that COLA every five years, some will receive it every 35 years.

Based on those analyses they'll come up with an average of what that time period is and that number should, at the very least, have some correlation to how long that dollar figure is amortized over.

DIRECTOR McANENY: Okay. Let's -- let's separate the two issues, which is the way it's done actuarially.

You have an analysis done of a projected life expectancy and projected costs associated with that.

But everything gets brought down to present value. You don't use the future cost. You use the present value of the future cost.

Because there's going to be interest earned, interest paid. Those things in between, all through.

You then have an actuarial pay-off period. You don't allow that debt to sit out there based upon the life expectancy -- the life expectancy of that population.

The life expectancy of the population already got included in the calculation for purposes of what is the dollar cost. It's in there once. Okay?

If you extend it any longer than that, first of all, you're going to end up paying a lot more interest over a longer period, because the longer the time frame the more interest you're paying.

But we have a statutory structure that says we're not going to allow those newly created liabilities to just go on forever that way.

And you're talking about a total

revamping of the state retirement systems and how they amortize benefit changes. That's more than just an actuarial analysis. That's -- that's going right to the heart of the system itself.

You could end up paying a lot more but, more importantly, you're going to end up with new liabilities being created because you're going to have another COLA and you still haven't paid off the COLA before it and you're just going to keep stacking COLA on COLA on COLA on COLA, and it's going to be -- yeah, you're just going to keep digging the hole deeper. Then somebody is going to have to come and take your shovel away.

REPRESENTATIVE BOYD: And, yeah, my -- my concern is we should, if anything, prefund. If we're going to pass a COLA, we should prefund it.

DIRECTOR McANENY: I'm a hundred percent behind that.

REPRESENTATIVE BOYD: Okay.

DIRECTOR McENENY: The commission issued a report on that back in -- I believe it was 1992 saying that very thing.

REPRESENTATIVE BOYD: Thank you.

CHAIRMAN LEVDANSKY: Thank you.

Chairman Nickol.

REPRESENTATIVE NICKOL: Thank you. I guess the problem prefunding COLA's is usually you face a dilemma. A COLA is on the agenda and to prefund the future COLA you're like doubling the cost up-front as you move into a prefunding situation.

DIRECTOR McANENY: Correct.

REPRESENTATIVE NICKOL: I -- Representative Sainato had asked a question and he wasn't here in the '90s, but I think the '90s gave people a perception that COLA's were free.

Because during those years isn't it the case that, with the pension funds earning double digit returns and the actuarial value of assets climbing, we had a falling contribution rate and so the rate might fall four percent one year and you could deliver a two percent COLA or a COLA that was equivalent to two percent of the rate, so the rate continued to come down even as you were granting COLA's during that period creating the impression that you had free COLA's?

DIRECTOR McANENY: That's absolutely correct and it's a direct result of the fact that contributions -- mandatory contributions to the state and school employee retirement systems are not tied to normal costs.

Normal cost is what it's going to cost every year to just maintain the existing plan for the existing employees. And if you're not making normal costs, you're drawing money out of the savings.

And we took holidays. We just said we don't have to contribute anything, and not only was the COLA free, the whole pension system was free. I mean it was wonderful.

So now we're paying for it. No pun intended.

REPRESENTATIVE NICKOL: Kick the can down the road and here we are.

DIRECTOR McENENY: Yeah. We ran into the wall.

REPRESENTATIVE NICKOL: I appreciate your comments in response to Representative Levdansky's thought about getting some kind of an actuarial review before bills are run in committee.

Because of the change in House rules, with us amending the second consideration, if we don't get some kind of a review in advance, it puts us in a difficult position should there be any amendments.

And I know many of your actuarial notes contain help or technical amendments that essentially clean up the bills. And so if we get those in advance, it's something we can do in committee and it makes things a little bit more tidy than not having to deal with those issues when we get to the floor.

DIRECTOR McANENY: Well, thank you very much. Normally people just refer to them as technical amendments. That's the first time I've heard them referred to as helpful.

We do appreciate that. We do try.

REPRESENTATIVE NICKOL: It's a new one.

You had -- you had mentioned about you don't want to have the pension police. And my understanding is that Act 205 which started -- which required municipalities to contribute a minimum amount each year --

DIRECTOR McANENY: Yes.

REPRESENTATIVE NICKOL: -- toward their pension obligations. What happens if a municipality doesn't make that contribution required by Act 205? If you're not the police officer, who is?

DIRECTOR McANENY: Well, we actually are in that case. We make them do it.

And we have taken them to Commonwealth Court for writs of mandamus in order to compel that very thing. So in that regard we are.

What we're not the pension police on is what is the structure of your plan, what are the benefits provided, and how do you administer it.

And that's way beyond the capacity of any state agency that I'm aware of to be able to handle. There's just no method to the madness.

REPRESENTATIVE NICKOL: I was surprised when you had said that you have the same number of plans -- I believe this was what you had said -- when Act 205 passed we had the same number of plans today that are underfunded that we did back in 1985, which was a surprise to me because if municipalities have been making that required contribution, shouldn't they have caught up and be fully funded today?

DIRECTOR McANENY: Yes. But, again, that also assumes that the plan stay the way it was as far as its benefit structure and its administration. And the reality has been that it has not.

REPRESENTATIVE NICKOL: So you're saying they were using their shovels in the interim?

DIRECTOR McANENY: Oh, yes, sir. Power equipment.

REPRESENTATIVE NICKOL: I wanted to follow up on a response you had to Representative Frankel's question. I'm curious about the 20-year no call bond.

Was that a pension obligation bond so it's actually a liability to the city of Pittsburgh as opposed to the pension fund itself?

DIRECTOR McANENY: It's a liability of the city of Pittsburgh. They used it to fund pensions, but they pledged the full faith and credit of the city rather than the future receipt of state aid.

Act 205 does make reference to a type of pension bond where they pledge state aid against it. That is not what this was. This was done by the city itself.

It was really kind of famous when they did it. It was the first Internet auction of government bonds. They were going to save all this money on the administrative side. And I assume they did.

But it's created a real monster because they've got a high interest rate and they -- they're stuck with it. They have to pay it year after year after year. They can't call the thing.

REPRESENTATIVE NICKOL: Okay. But it would be a liability of the city itself?

DIRECTOR McANENY: The city.

REPRESENTATIVE NICKOL: Not the pension fund?

DIRECTOR McANENY: It's of the city. But we allow them to utilize the dollar value in calculating their pension liabilities for state aid purposes. It's not truly a liability of a pension anymore, but it's still utilized as if it were for purposes of state aid.

REPRESENTATIVE NICKOL: And just one final comment. I actually did read your divestment report.

DIRECTOR McENENY: Oh, my God.

REPRESENTATIVE NICKOL: I read it.

DIRECTOR McANENY: I hope you slept well.

CHAIRMAN LEVDANSKY: Mr. McAneny, thank you so much for your -- your information and appearing before the committee and your insights and help in answering our questions as well.

DIRECTOR McANENY: Any time.

CHAIRMAN LEVDANSKY: Thank you. Thank you.

Next -- we're running a little bit late -- Mr. James Allen, the Secretary of the Pennsylvania Municipal Retirement System.

SECRETARY ALLEN: Thank you, Mr. Chairman, and good afternoon.

On behalf of the Pennsylvania

Municipal Retirement System, or PMRS, as we are more commonly referred to, I'd like to share our story with the Finance Committee of the House of Representatives.

As secretary, a title designated in our creating legislation, Act 15 of 1974, I have had the privilege since September of 1984 to lead our agency and to share our story with many interested and widely diversified individuals and groups.

I look upon this occasion as one of the most critical presentations I will ever make for I believe you, as members of the General Assembly, are at a crossroad as to how public policy affecting the retirement of tens of thousands of Pennsylvania's public servants will be crafted for the next several generations.

I commend you for facing this task with the willingness to seek a better understanding of the current actors in the arena.

Now to our story. Yes, we are a state agency. Yes, there are three statewide pension plans, not two. And, yes, it is highly likely that you have never heard of us. You are not alone.

Some quick facts about us:

One: We are an independent state agency. Read: Not under the Governor's jurisdiction.

I am appointed by an 11-member board that has fiduciary responsibility for the Pennsylvania Municipal Retirement Fund.

Two: The board is composed of the State Treasurer, who is also the custodian of the system's fund, the Secretary of the Commonwealth, and nine other individuals who are in most cases to be specifically nominated to the Governor who has the prerogative to appoint them to two four-year terms.

The designated nominating organizations are:

The County Commissioners Association;

The Pennsylvania League of Cities;

The Pennsylvania Association of Township Commissioners;

The Pennsylvania State Association of Township Supervisors;

The Pennsylvania State Association of

Boroughs;

And the Pennsylvania Municipal Authorities Association.

Two individuals who are active members of the system are to be nominated, one each, by associations representing municipal firemen and municipal police. The final appointee is to be a retiree, a retired member of the system.

Municipalities may optionally enroll their pension plan or plans in PMRS by adopting an ordinance and executing a contract and having at least 75 percent of the existing members of that plan to be enrolled approve of the transfer to the PMRS.

As of today, we have over 865 individual pension plans ranging in size from the city of Allentown's municipal employee pension plan with over 550-plus active and vested members and another 175 retirees and with assets of over a hundred million to approximately a dozen plans with no active members, just one or two retirees, and a hundred thousand or so in assets.

I stray from my testimony just to

make a brief point. There was an issue of defined benefit, defined contributions. Of our 865 plans, right now 683 are DB plans and another 180 plus are DC plans.

Back to the remarks. Combined our board has fiduciary responsibility for approximately 14,000 current or former public employees and approximately 1.5 billion in assets.

Some of the more interesting facts about our agency are:

Each plan defines its own benefit structure. We have some municipalities that -- with benefits that are better than those offered by SERS, and we have other plans that can only be defined as bare bones plans.

Each plan's actuarial experience, their individual cost, is determined independently of any other plan within the system. We have plans that have a normal cost as high as 40.2 percent of payroll and some that have a normal cost of less than three percent of payroll.

Just as interesting is that we have plans that are as much as 1,200 percent funded and others that are -- and one that is only 13 percent funded.

The system pools for certain types of costs or experiences: Retiree life expectancy, disability funding, administrative costs, and investment performance.

We administer to these plans with a staff complement of less than 30 employees at the current time and with no state funding. All of our revenue for operating our agency comes from the fees we charge our plans and a portion of the investment income we make off of the portfolio.

As to this last part -- point, our source of revenue, I need to interject that authorization to use a portion of our investment income to operate the system is derived from a section of law -- our law that has historically been capped or grandfathered on a five-year basis.

Our authorization to use that source of revenue has expired, and we are in need of having it renewed. Senate Bill 1039, currently in the Senate Finance Committee, would retroactively approve the system's use of this revenue source for 2006 and 2007 and would also legitimize the funding source through to 2010.

This is a rather embarrassing problem that has repeated itself every five or so years going back even before my tenure as secretary.

It is this one issue where we as an agency interact with the General Assembly. This interaction is something of which I am not proud.

Everyone likes to talk about the money, so let me share some of the information about our portfolio. At year's end, December 31st, 2007 we had approximately 1.56 billion under management.

While certainly pale in comparison to PSERS or SERS, we are still ranked the 638th largest pension plan in the United States by the trade publication Pension and Investments.

I list our asset allocations. I don't need to read those numbers to you.

Because of legislative and structural designs, we must take an extremely conservative approach to our portfolio.

We assume an actuarial investment return of six percent net of expenses and we must book a six percent return to all of our plans every year regardless of what we make or don't make.

We have no investments in hedge funds, private equity, or venture capital. About as exotic as we get is our 42 million in forest acreage.

We employ 12 different money managers and one investment consultant. As to performance, our conservative approach has hurt it when times are good, as you might imagine, and it has helped us when times are not so good.

I share our information as compared to the SERS portfolio based on our two published comprehensive annual financial reports or CAFRs for the last ten years.

I would interject here that PMRS's return for last year, 2007, is 8.2 percent. I do not know what SERS is.

While the returns may not be as much as we would have liked, we are nevertheless proud of them. We believe that through full market cycles we have proven that we can maintain a performance that ranks in the top third of our class of peers.

I believe I may have imposed on your generous invitation, but I would be remiss if I did not share one additional very important fact about our agency. We are extremely frugal and very proud of it.

While it is the design of the system that we have to be conservative, whether it -- whether -- yeah -- where -- whether it is the design of the system that we have to be conservative or whether it's the make-up of the board where over half of the board members will still get their benefits from the system, thus making the task of watching this money as if it was their own or whether it is the entrepreneurial nature of our agency, our plans do not have to join us. They can do it themselves or contract with a private provider. Whatever the reasons, we do watch our pennies.

I leave with you another set of numbers that are attached to this testimony.

They, too, are drawn from PSERS, SERS, and PMRS CAFRs. While they probably do not get as much attention as the investment portfolio numbers, they are very important to our board, our staff, and our membership.

I close by thanking you once again for your patience and for your invitation. I welcome your questions.

And I would just call the attention to the sheet. What I have done is lifted off of the CAFRs the expenses, be they administrative, investment, or commissions and the numbers of memberships covered, and you'll see the average cost.

And I'll be happy to take your questions.

CHAIRMAN LEVDANSKY: Do any members have any questions?

Representative Boyd.

REPRESENTATIVE BOYD: With the vast number of different plans under one oversight, if you will, are those plans -- I'll use the term, it's probably not the best term, but the best one I can come up with -- portable? Meaning when somebody is in one municipal plan and they want to leave that position and go to work for another municipality, can they just shift it?

SECRETARY ALLEN: If a member of our plans leaves and goes to one that's enrolled within PMRS within one year, their benefit is portable. It's up to the individual to elect that. They may go to a benefit plan that is lesser, but it does have the option -- option to have portable. We probably process somewhere between 60 and 75 a year portable benefits.

REPRESENTATIVE BOYD: So I'm clear on how that would operate, if I work for Municipality A and the pension program with them was a defined benefit plan and provided for, let's say, 75 percent of my annual pay when I retired, given whatever, you know, details I would throw into that, you know, how many years of service and so on and so forth, and I wanted to go to work for another municipality and that pension plan only provided for 50 percent, what are my options?

SECRETARY ALLEN: Well, the first is you have an option to exercise that portability or not. If you elected to exercise that portability, what we do is calculate the present value of your accrued benefit with Municipality A, transfer it to Municipality B, and guarantee you have a minimum, minimum benefit equal to that present value.

That present value may grow, because you have a longer time period there. Maybe you only -- had a promise in Municipality A of 75 percent of pay but you only worked five out of the required 25 years, whereas you're going to work 20 years under Municipality B to get that.

So we transfer the present value of the accrued benefit and guarantee that at least -- you would at least get that, but you may be, if you will, wearing away that additional benefit until you get up to maybe 12 or 13 years in that example.

REPRESENTATIVE BOYD: Okay. Thank you.

CHAIRMAN LEVDANSKY: Representative Vulakovich.

REPRESENTATIVE VULAKOVICH: So

basically what you do is you represent all those that -- like, in other words in the cities and towns, the boroughs, the townships, a lot of them have their own pension plans. But if they choose not to, they're with you? Is that pretty much it?

SECRETARY ALLEN: They have their own pension plan. They've chosen us to be their administrator of that pension plan.

They have the option to self-insure, run it by themselves; they have the option to engage an insurance company or a third-party provider, the private industry, to manage that pension plan; or they have the option of coming to us as the state to take that.

We do everything from A to Z, invest the money, calculate the benefits, pay the benefits, and do the actuarial evaluations, that is correct.

We're an alternative to the private sector.

REPRESENTATIVE VULAKOVICH: Okay. So, in other words, instead of my township, for example, hiring it's own money manager, they would go through you and you would handle everything else?

SECRETARY ALLEN: That is correct. It's not just -- they can't select a service from us. It's an all or nothing.

If they want us to administer their program, we do the money management. We do the actuarial work. We do the benefit calculations.

So they're turning over the fiduciary responsibility to administer that plan to us. They still retain the rights to design the plan, the benefit structure. We tell them how much to pay for it and we administer it from there.

REPRESENTATIVE VULAKOVICH: The local board, the township commissioners, how does your fiduciary responsibility play into this? It doesn't?

SECRETARY ALLEN: Oh, they still retain the fiduciary responsibility, but they share it with us. We assume a large portion of that fiduciary responsibility.

But as the trustees of the original creator of the plan, the contract that gives them the benefit, they still have that liability and they're still the ultimate last guarantee.

REPRESENTATIVE VULAKOVICH: So are you still governed by Act 205?

SECRETARY ALLEN: Our plans are very much governed by Act 205, yes.

REPRESENTATIVE VULAKOVICH: So you --

SECRETARY ALLEN: In fact, I'm filling out 800 --

REPRESENTATIVE VULAKOVICH: You get your MMO's. So, for example, the local wouldn't get -- the local township wouldn't get the MMO? In other words you would?

SECRETARY ALLEN: No. The -- the -- we act -- again, it's -- if you will -- we are a third-party administrator. Act 205 applies to that municipal plan.

REPRESENTATIVE VULAKOVICH: All right.

SECRETARY ALLEN: They have to do their MMO. We do the actuarial work, tell them what their MMO is going to be, then they share that with us, what their payroll is, and we bill them.

They have to fund it and we make sure

they are in compliance with Act 205. They still have the responsibility, though, to fund the MMO we created.

REPRESENTATIVE VULAKOVICH: Now, as far as employee contribution, if their fund is overfunded, not actuarially sound, a lot of times --

SECRETARY ALLEN: There's a big difference.

REPRESENTATIVE VULAKOVICH: -- you're actuarially sound, and they say, oh, boy, you know, the pension fund is funded. One -- but if the employees do not contribute and have to contribute, because of some -- in the contract where it says, if you reach a certain point, you must contribute to the pension fund.

For example, my police pension back home was five percent. There was times for a few years they contributed nothing, and then because of some added benefit or downfall in the investments, they might have had to contribute 1.3 percent or something like that.

How does that play in with you? You make sure they --

SECRETARY ALLEN: Well --

REPRESENTATIVE VULAKOVICH: What?

SECRETARY ALLEN: Well, yes. The answer is the same provisions that apply under Act 600, under Act 205, all those other acts that Jim McAneny was just explaining, apply to our member plans.

What happens though in our situation, your municipality would have joined us and if they were a typical, if there is such a thing, Act 600 plan, that contract would have said that their police officers have to contribute five percent of their pay, but they may waive them on an annual basis or for a three-year time period or whatever the collective bargaining.

So they contractually waive that every -- for a limited time and then they have to re-enact that waiver or if they -- again, this can't happen under an Act 600 plan, but if they said that, you know, there's no member contributions, we have plans that have no member contributions.

REPRESENTATIVE VULAKOVICH: Well, one of the problems is that Act 600 has never been redone. Nobody wants to touch it.

And the contracts have basically -- they got legal advice on whether you can do this under Act 600 or not. That's why some places have overtime included in their -- in their calculation for their pension. Others don't.

There's been case law. There's like three cases on that, too. Act 600 is just, you know --

SECRETARY ALLEN: I agree. I think what Jim, if the take-away, if I could, from Jim McAneny is that you have state law, you have constitutional law, and then you have collective bargaining, and the three do not always go in sync.

REPRESENTATIVE VULAKOVICH: With Act 600 being on silence.

Okay. All right. Thank you.

CHAIRMAN LEVDANSKY: Any other questions from members?

Just -- just two quick from me, Mr. Allen. I think there's been some discussion in the Senate about making future municipal employees become part of the state retirement system.

SECRETARY ALLEN: A state retirement system. Not the state retirement system.

CHAIRMAN LEVDANSKY: Okay. Yeah. Could you elaborate on that and, you know, how would that work and is this a good idea in your judgment?

SECRETARY ALLEN: First, let me give you the official position and understanding.

The Pennsylvania Municipal Retirement Board, who I work for, has taken a very clear stance and said if there is to be a statewide system we are the logical entity to be that statewide system.

Secondly, they said as to whether there should be a statewide system or not, that's not for PMRS to decide. That's for the boroughs, the townships, the General Assembly to debate.

I get paid from 865 pension plans to administer those pension plans. I don't get paid to lobby for being a bigger agency or not being a bigger agency.

What the board has been very consistent about over all the years that this has been proposed, is that if it is an agency, the logical repository would be PMRS because we do that now. It's only a matter of scalability.

As to the merits of such a legislation, I would say that I have to step out of my role as executive -- or the secretary of the agency and give you a personal opinion because I can't do that in an official capacity.

I believe that the General Assembly has dramatically failed in understanding the issue of public pensions.

You opened the door very widely in asking Jim McAneny, what is the major issue facing public pension plans?

I'm going to come back to that with saying that the major issue failing -- the major failing of the state right now is that we don't have a public policy on retirement.

How can you tell me what is a good pension and what is a bad pension? Is it one that gives you 75 percent of pay with or without Social Security? Is it one that allows you to retire at 60 versus 65?

We do not have in this Commonwealth, nor does this country unfortunately, have a public policy statement on what is a good retirement system.

So how do you benchmark them when you don't have a benchmark? It gets straightforward in looking at it that way.

Secondly, if you want to assume responsibility, because I do know my constitutional law to the -- very limited, I'm not an attorney, but municipalities aren't creatures of the state.

If you want to say as creatures of the state you want to assume responsibility for their pension plans then, yes, it makes sense to say that there should be a statewide system.

If you want to recognize those 3,000-plus entities as separate employers with separate rights for collective bargaining, separate rights for setting their wages, separate rights for vacation and leave policy, why would you preempt them and take away their additional pension right benefits?

Why do you -- why would you want to

say that this Commonwealth is going to set the pension plan benefits for every private employer in this Commonwealth?

Do you have the constitution -- I mean the institutional wisdom to say what's good for XYZ municipality as an employer?

CHAIRMAN LEVDANSKY: One other area. Given the --the enormous numbers of municipal retirement plans, do you think that consolidation of these local public pension systems -- is it -- is that a viable idea and is that something that the legislature ought to undertake?

SECRETARY ALLEN: Clearly it goes without saying that there is going to be a certain critical mass where the economies of scale kick in. Absolutely. It goes without saying that that's a fact.

The reality is, though, how do you bring that about? Do you force it as a mandate? Or I've said from day one the General Assembly has failed -- if that was your goal, to get back to the issue, do we have a public policy on pension plans in this Commonwealth? No.

If we did and that policy said consolidate and save costs, why wouldn't you structure Act 205 to set an incentive in terms of reimbursing and reimburse a hundred percent of the cost for those that have a consolidated pension plan benefit structure and only 75 percent for those who don't? Why don't you use the carrot-and-stick approach?

If you wanted to say a consolidated plan, in its smaller size, why don't you say every plan under five employees must be in a statewide plan or a consolidated plan?

Or there are other ways to get to it. To me, you haven't set the benchmark of what you really want so that we could properly answer and divine your -- the way to get there.

CHAIRMAN LEVDANSKY: Thank you.

Chairman Nickol.

REPRESENTATIVE NICKOL: Thank you. I'd like to go back on Representative Boyd's question on portability.

I'm curious what you do. You said about transferring the present value of accrued benefits. What -- how do you do that when you have -- you said you had a range of plans, some with as low as 13 percent funding. If they don't have the money in the system, how do you transfer the benefits?

SECRETARY ALLEN: Well, there's -- there's -- should always be money in the system. Very, very rarely do we run into a negative value.

But if a municipality -- if an individual had five years of service, we calculate his benefit as if he was going to take a vested benefit, the accrued value of that benefit, the present value at this present point in time, and we say, okay, his personal contributions may be $4,000 and the overall benefit value that he's earned is $15,000, we'll take $11,000 out of that municipality's pension plan and transfer that $15,000 into Municipality's B pension plan and say, Jim Allen, in Municipality B you have a benefit worth at least $15,000.

Now, in reality, he may have his five years over in Municipality B, and given the lower benefit structure, that present value there may be only 12,000. That's where the wear-away comes in for the 3,000 until he gets -- works another three or four years and then it kicks up in that way.

That's why it's an optional provision for that employee.

REPRESENTATIVE NICKOL: If -- if a municipality opts into coverage through PMRS, can we opt out as well?

SECRETARY ALLEN: Yes. And that's really one of the major reasons why we have to have such a conservative approach to our investment return.

If the municipality joins PMRS, as I said, they have to have a majority vote of the governing body and the 75 percent vote of those plan participants, of those coming in.

Once they're in, they're in for five years. The law says they cannot withdraw until five years after that . They may withdraw after five years at any time, again, with majority of vote of counsel or the governing body and 75 percent vote of the plan participants.

Our average has been between 15 and 25 new plans a year. That's net. We probably lose three plans, for a year or so has been our average.

REPRESENTATIVE NICKOL: If I recall Jim's testimony, there's about 3,000 or so municipal pension plans in Pennsylvania and you have, what, 865? About 28 percent of them are members of PMRS?

SECRETARY ALLEN: We -- we say we have about 25 percent of Pennsylvania's public pension plans and about -- we cover about 10 to 11 percent of the workforce. So that gives you the small nature of us.

REPRESENTATIVE NICKOL: When -- what -- I was looking at your returns on -- your earnings and in seven of the ten years you exceeded your assumption of six percent.

What do you do with the additional monies? I mean I assume you don't take that home in a paycheck. I mean how is that apportioned or used for the benefit of the members?

SECRETARY ALLEN: Every -- when I said we pool investments, every one of our plans will get a six percent return this year. No matter what the market does, we must credit them six percent.

We do have what we call an undistributed earnings to pay for down years and that can be as much as ten percent of our overall assets. The highest it's ever been has been nine percent, and that was starting in 2002. So we were able to weather some of it.

We can also have a negative resource, if you will, when the market goes less than that.

If we make more, as we did -- and let's go back to 2006. We made 12.6 percent. We credited everybody's account the six percent. That's employer and employee. We put some aside into our reserve. We put about two percent of that into a reserve, undistributed earnings, and then -- and I say it this way. The law says we pay excess interest. We paid a dividend.

Each plan for every hundred dollars they got -- the number escapes me -- I think it was a 3.51 percent bonus.

And that -- this is where some of you may find this interesting, is each individual municipality decides what to do with that bonus. It must stay in the pension plan under federal law. The municipality can do, as some have argued the General Assembly should have done, and use that as an actuarial surplus to pay for future down years. It's an actuarial gain.

They can give it to their active members, in which case we have a separate account for Jim Allen, plus he has excess interest over here, which acts much like a defined contribution piece.

We divide that at time of retirement by an annuity factor. So he may get 50 percent of pay under his plan but he may have $5,000 built up in excess interest bonus which will convert to an extra $50 a month for that individual.

Or we may return it in a cost-of-living increase. If there -- if everybody -- a municipality said we're going to do all three, give an equalized yield on our dividend as of January 1st, well, at the end of January, we paid out those retirees, existing retirees 3.12 percent. I'm choking on this cost of living. It has nothing to do with the consumer price index but it has to do with our investment return. So we pay them a dividend.

REPRESENTATIVE NICKOL: And that 3.1 percent, that's for that year or does that increase their base in --

SECRETARY ALLEN: No. That's prefunded. We take that, the three-and-a-half -- the 3.12 percent of excess interest and convert that into an annuity value so it funds his benefit higher for the rest of his life.

REPRESENTATIVE NICKOL: Do you have members in your plan who are participants in Social Security and some who are not participants in Social Security who may --

SECRETARY ALLEN: Out of the 865, I think all but six or seven are covered by Social Security.

REPRESENTATIVE NICKOL: Are all those uniform plans that are not covered?

SECRETARY ALLEN: No. I have one, at least one of them is a nonuniform -- two of them are nonuniform plans that are not covered by Social Security.

REPRESENTATIVE NICKOL: Okay. Thank you.

CHAIRMAN LEVDANSKY: Mr. Allen, thank you so much for your insights and the information you shared with us.

SECRETARY ALLEN: Again, thank you for your invitation.

CHAIRMAN LEVDANSKY: Just one final thing just for the members who are here. We'll send out an e-mail follow-up to this. But in addition to the hearings, tomorrow and Wednesday in Harrisburg, next week the Finance Committee will be having a hearing on Monday afternoon in Montgomery County on the research and development tax credit and on Tuesday, March 4th, in Philadelphia on House Bill 2196, the youth employment tax credit. But we'll get out an e-mail and hard copies to everybody here on that.

Thank you so much for being here today.

(The proceedings were concluded at 4:00 p.m.)

I hereby certify that the proceedings and evidence are contained fully and accurately in the notes taken by me on the within proceedings and that this is a correct transcript of the same.

____
Brenda S. Hamilton, RPR
Reporter - Notary Public