

**PUBLIC EMPLOYEE RETIREMENT COMMISSION**

**PUBLIC HEARING ON LOCAL PENSION PLANS**



*Auditor General Jack Wagner*

**September 19, 2012**

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*Deputy Auditor General For Audits Thomas Marks*

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Good morning, Chairman Salomone, Executive Director McAneny, commission members, legislative appointees and other attendees.

Thank you for the opportunity to discuss the very important issue of public pension reform in the Commonwealth of Pennsylvania. While much of the discussion today will center on the Public School Employees' Retirement System and the State Employees' Retirement System pension plans – both of which face significant challenges of their own – we should not neglect or overlook the need to discuss pension reform at the local government level as well.

The Commonwealth of Pennsylvania has more than 3,200 local government pension plans – an extraordinarily high number that accounts for about one-fourth of all the municipal pension plans in the United States. These plans provide retirement benefits to police officers, firefighters, and non-uniformed personnel.

The Department of the Auditor General is responsible for auditing about 2,600 of Pennsylvania's 3,200 local government pension plans; the remaining 600 are county and municipal plans over which we have no jurisdiction.

The main reason Pennsylvania has so many municipal pension plans is simple – we have more municipal governments than any other state in the nation. And many of

these municipalities are so small that you might say we are a commonwealth of micro-governments.

To illustrate my point consider this: the median size of a municipal government in New Jersey is about 22,000 people; in Pennsylvania, it's 1,900.

A consequence of our many micro-governments has been a proliferation of micro pension plans. Roughly two-thirds of the municipal pension plans that we audit in Pennsylvania have 10 or fewer members.

By comparison, according to a recent survey conducted by the U.S. Census Bureau which reported the number of defined benefit plans maintained by state and local governments, the states surrounding Pennsylvania have done a much better job of limiting the number of small municipal pension plans.

In West Virginia, there are only 40 local government defined benefit pension plans. In Maryland, there are 14; in New York, 8; in Delaware, 5; and in New Jersey, 3.

The Department of the Auditor General's Bureau of Municipal Pension Audits conducts audits of the 2,642 pension plans established by Pennsylvania municipalities and regional entities that participate in the state's General Municipal Pension System State Aid Program. Our audits determine whether the local government pension plans are administered in compliance with state laws, contracts, administrative procedures, and local ordinances and policies. Of these 2,642 pension plans, 963 cover police officers, 81 cover paid firefighters and 1,598 cover other non-uniformed municipal employees.

To help the General Assembly and the taxpayers of Pennsylvania understand the challenges going forward, the Department of the Auditor General -- the state's independent fiscal watchdog -- has completed a special report, issued today. It's called *Analysis of Local Government Pension Plans*, and it examines the financial condition of local government pension plans that receive state aid to cover uniformed and non-uniformed employees in Pennsylvania's cities, boroughs, and townships.

Our review included an emphasis on data collected from audit reports of local government pension plans released between July 1, 2009 through June 30, 2011. It identifies the most common audit findings of the pension plans and highlights the funding status of individual pension plans pursuant to distress recovery parameters set by the Financially Distressed Municipal Pension System Recovery Program, established by Act 44 of 2009.

Based on the Financially Distressed Municipal Pension System Recovery Program and data obtained from PERC, our special report presented the pension plans in three categories. They are:

- Severe Distress (less than 50 percent funded): 52 plans, or 2 percent, fall into this category.
- Moderate Distress (50 – 69 percent funded): 234 plans, or 9 percent.
- Minimal Distress (70 – 89 percent funded): 633 plans, or 25 percent.

Between July 1, 2009 and June 30, 2011, the Department of the Auditor General released 2,023 audit reports of local government pension plans; 32 percent, or 647,

of those audits cited pension plans for errors resulting in \$2,074,829 due back to the commonwealth, in addition to other monetary effects totaling \$5,022,549.

Our special report identified seven common deficiencies in the municipal pension plans -- including three issues that affect the financial health of the local government pension plans. They are:

- Providing excess benefits that require higher municipal contributions necessary to fund pension plans in accordance with Act 205 funding standards.
- Submitting inaccurate payroll and employment data. Payroll and employment data is used to determine the amount of state aid due to municipalities for distribution to pension plans to assist in covering pension plan costs.
- Failure of municipal pension plan officials to determine and to pay minimum municipal obligation annual funding requirements.

In July of 2008, I initiated a new policy within the Department of the Auditor General which established that errors that result in an underpayment of state aid to a municipality may, under certain circumstances, be rectified by the distribution of additional state aid to affected municipalities. As a result of this policy, between July 1, 2008 and June 30, 2011 the Department of the Auditor General issued payments totaling \$687,623 to local government pension plans that qualified for the reimbursement – to assist the plans’ in maintaining a satisfactory funding level. While those reimbursement dollars help pension plans in meeting their obligations, they do not cure the problem. There must be comprehensive reform to address the funding challenges faced by local government pension plans.

Given the current economic conditions of the commonwealth and the ever-increasing strain that the funding of municipal pension plans is placing on local governments, the time is now to discuss changes to Pennsylvania's municipal pension system – changes that must balance the obligation of providing retirement benefits to hard-working, policemen, firemen and other public servants, with the need to protect taxpayers in these challenging economic times.

In a spirit of bipartisan cooperation, I will outline several common-sense proposals that I believe the General Assembly and the Corbett administration should consider as part of any solution to municipal pension reform. As always, I stand ready and willing to work with you to effect these changes.

Here are my proposals:

- First, the General Assembly should consider consolidating local government pension plans into a statewide system for different classes of employees that would apply to current and/or future municipal employees. An alternative solution would be to maintain the existing system of individual pension plans but consolidate their administration into one entity such as the Pennsylvania Municipal Retirement System or the State Employees' Retirement System.
- The General Assembly also should consider amending the formula for the allocation of General Municipal Pension System State Aid funding to ensure that distressed pension plans receive additional funding.
- Due to demographic changes, such as increased life expectancies, pension plans' normal retirement provisions should maintain a

balanced age and service component and not rely solely on a years-of-service formula that can dramatically increase a pension plan's actuarial accrued liability.

- And finally, there needs to be a full debate in the General Assembly regarding benefit structures to be maintained by local government pension plans. For example, these possible structures include defined benefit plans, defined contribution plans, and hybrid plans that incorporate features of both defined benefit and defined contribution formulas.

Besides these recommendations, there are several policy and procedural modifications that could be made to improve the administration of local government plans. For example:

- Municipal officials should review the benefit structure and the funding of a defined benefit pension plan from a long-term perspective and not let temporary market fluctuations influence their decisions regarding investment policy and benefit modifications.
- Plan officials should consider consulting with legal counsel, plan consultants and actuaries prior to making decisions regarding amending the plan's benefit structure and funding levels.
- Plan officials should consult available reference sources, when possible, when making investment decisions or in the consideration of changing plan custodians.

- Plan officials should monitor custodial account statements to make sure all state aid is properly deposited into eligible pension plans to fund authorized pension plan costs.

In closing, I want to commend the Public Employee Retirement Commission for its independent oversight of local government pension plans. I also wish to acknowledge the contributions of PERC in the development of the Department of the Auditor General's *Analysis of Local Government Pension Plans* special report.

I hope you will find the information in this report helpful in bringing about necessary changes to Pennsylvania's local government pension plans. The Department of the Auditor General looks forward to continuing to work with you on this important issue. I would be happy to answer your questions.

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