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USING PUBLIC PENSIONS TO BALANCE STATE AND LOCAL BUDGETS: THE IMPACT ON PUBLIC EMPLOYEES, RETIREES, AND TAXPAYERS

JOINT HEARING

BEFORE THE

SELECT COMMITTEE ON AGING

AND THE

SUBCOMMITTEE ON INVESTMENT, JOBS, AND PRICES

OF THE

JOINT ECONOMIC COMMITTEE
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

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USING PUBLIC PENSIONS TO BALANCE STATE AND LOCAL BUDGETS: THE IMPACT ON PUBLIC EMPLOYEES, RETIREES, AND TAXPAYERS

WEDNESDAY, NOVEMBER 20, 1991

U.S. HOUSE OF REPRESENTATIVES, SELECT COMMITTEE ON AGING, JOINT WITH THE JOINT ECONOMIC COMMITTEE, SUBCOMMITTEE ON INVESTMENT, JOBS, AND PRICES,
Washington, DC.

The committees met, pursuant to notice, at 9:38 a.m., in Room B318, Rayburn House Office Building, Hon. Edward R. Roybal (chairman of the Aging Committee) and Hon. Pete Stark (chairman of the Subcommittee on Investment, Jobs, and Prices) presiding.

Members present: Representatives Roybal, Stark, Rinaldo, Borski, Pallone, Swett, DeLauro, Boehlert, Fawell, James, Houghton, Taylor, Nichols, Fish.

Staff present: Select Committee on Aging: Richard Veloz, Staff Director; Valerie Batza, Assistant Staff Director; Paul Ceja, General Counsel; Gladys Rodriguez, Professional Staff; Rigoberto Saborio, Research Assistant; Stephanie Jones, Staff Assistant; Carolyn Griffith, Research Assistant; Mary Wunderlich, Staff Assistant; Austin Hogan, Communications Director. Joint Economic Committee: Steve Baldwin, House; Susan Lepper, Senate; Stan Clemons; Anne Raffaelli, Legislative Counsel, Chairman Stark's office.

OPENING STATEMENT OF CHAIRMAN EDWARD R. ROYBAL

Chairman ROYBAL. Ladies and gentlemen, we will start the hearing in just a moment. I would like to first of all welcome the witnesses and those who are here and interested in what this committee is doing.

The committee now will come to order. Ladies and gentlemen, today's hearing is a joint hearing. With me is Congressman Stark who heads the Investment, Jobs, and Prices Subcommittee, of the Joint Economic Committee, and I am the Chairman of the Select Committee on Aging.

This hearing is to review the nationwide trend by State and local government officials to divert the pension funds of public workers and retirees for budget balancing purposes. The hearing will attempt to determine the short and long-term economic impact to this Nation, and we hope we can start a discussion of possible Federal legislative responses.

In my opinion, this trend is a cause of concern not only for public workers and retirees but for all taxpayers, as all would be impacted by this short-sighted policy.

The Aging Committee has had a longstanding interest in protecting private pension funds from diversion by private employers, diversions that threatened the financial security of private employees and retirees. What State and local government officials are now doing to public pension funds is similar to that what occurred in the private sector. But there is one important difference. Public sector employees and retirees do not have the Federal protections that private employees have to preserve the financial integrity of those pension funds and benefits. Therefore, millions of public employees and retirees—maintenance workers, cafeteria workers, teachers, clerical workers, police officers, firemen and other workers all who have dedicated a lifetime of service to the public sector—have had their confidence in their retirement security undermined by the recent actions of State and local governments.

Today's witnesses will include State government financial officers who are themselves concerned by this trend, public pension fund legal and economic experts, and leaders of public employees unions. We tried to get a cross-section of the community to testify so that we can get the information from all sides. And drawing from this testimony, we will make recommendations, that we hope can do some good in regard to this specific problem. I am certain that the witnesses who testify before us today will be able to provide the information that we desperately need, and that will assist us in developing solutions

This is a tremendous problem, ladies and gentlemen. We have had hearings, as I have said, in the private sector, and now we are going to the public sector. This is happening not only in my State of California, but my understanding is it is happening in other States of the union. It is, therefore, necessary for the Congress of the United States to look at the matter, to study it, to find out what the situation is, and why these things are going on. And to do everything possible to protect the person that makes the investment; that is, the current and future retirees. I believe that it is their money, no one else's and, therefore, we must do everything we possibly can to protect the rights of the retirees'. I now recognize my co-Chairman, Congressman Stark.

[The prepared statement of Chairman Roybal follows:]

U.S. House of Representatives
Select Committee on Aging
Washington, DC 20515

Telephone: (202) 226-3375

OPENING STATEMENT
CHAIRMAN EDWARD R. ROYBAL

JOINT HEARING BEFORE THE HOUSE SELECT COMMITTEE ON AGING AND THE JOINT ECONOMIC COMMITTEE'S SUBCOMMITTEE ON INVESTMENT, JOBS AND PRICES

"USING PUBLIC PENSIONS TO BALANCE STATE AND LOCAL BUDGETS THE IMPACT ON PUBLIC EMPLOYEES, RETIREES AND TAXPAYERS"

Wednesday, November 20, 1991, 9:30 A.M.
Room B-318 Rayburn House Office Building

Today's hearing is to review the nationwide trend by state and local government officials to divert the pension funds of public workers and retirees for budget balancing purposes. The hearing will attempt to determine the short and long-term economic impact of this action, and begin a discussion of possible federal legislative responses.

The reasons behind this trend are clear. Public employee pension plans, which provide the retirement benefits of millions of state, city and county government workers and retirees, have seen an increase in assets from approximately $200 billion in 1980, to nearly a trillion dollars today. At the same time, state and local governments, facing increasing budget deficit problems, due to the federal funding cut-backs of the 1980's, the recession, and other factors, are looking for alternative sources of revenue.

In my view, however, utilizing public pension funds for general revenue purposes should be a cause of serious concern, not only for public workers and retirees, but for all taxpayers -- as all may be impacted by this short-sighted policy.

The Aging Committee has had a longstanding interest in protecting private pension funds from diversion by private employers -- diversions that threatened the financial security of private employees and retirees. What state and local government officials are now doing to public pension funds compares with what happened in the private sector.

But there is one important difference -- public sector employees and retirees do not have the federal protections that private employees have to preserve the financial integrity of their pension funds and benefits.

Therefore, millions of public employees and retirees -- maintenance workers, cafeteria workers, teachers, clerical workers, police officers, firefighters, and other government workers who have dedicated a lifetime of service to the public sector -- have had their confidence in their retirement security undermined by the recent actions of state and local governments.

State and local governments are engaging in a variety of methods to interfere with and divert their public pension funds including delaying or reducing contributions to the funds, changing the actuarial assumptions that determine contribution levels, taking loans or simply withdrawing money from the funds.

Regardless of the method, the result is the same -- the hard-earned retirement funds of public workers and retirees are being used for purposes other than that for which they were intended, and are being put at risk.

I recognize the substantial budget difficulties that state and local governments are currently suffering. But by looking to public pension funds as a short-term budgetary solution, they may only be delaying, and possibly creating even greater financial problems over the long-term -- problems that could adversely impact both taxpayers, and public employees and retirees, alike.

In the future, will taxpayers confront major tax increases, and public employees cuts in their pension benefits, in order to offset current reductions in pension funds?

In answering this question, we should not ignore the fact that this nation has an aging population, which will result in more retirees putting more pressure on pension systems generally. Continuation of this policy therefore, may lead to increased intergenerational conflicts, if, in the future, a smaller population of younger workers is asked to finance, through additional taxes, a growing number of retirees.

One way to protect the future integrity, and financial stability, of public pension funds generally, is to provide some basic uniform fiduciary standards for the conduct of these plans.

These standards, for example, could require what is already federally required for private plans -- that public pension plans be handled prudently, and in the best interest of the plan participants and beneficiaries. In addition, uniform reporting and disclosure requirements could insure that public employees and retirees are made aware of the financial activities of the public pension plan.

Today's witnesses include state government financial officers who are themselves concerned by this trend, public pension fund legal and economic experts, and leaders of public employee unions. I am certain that they will be able to provide us with an understanding of the national scope of this problem, and some solutions for the future.

OPENING STATEMENT OF CHAIRMAN PETE STARK

Chairman STARK. Thank you very much, Ed. I appreciate you and your committee's quick call to action on this problem where I am afraid our colleagues and ourselves were slow to wake up. We may be in the process today of locking a barn door after the horse has been stolen. But it is important. I don't think that any of the Members or any of the witnesses have trouble spotting somebody who is purloining funds, but I do think we have some work to do to identify exactly the magnitude of the disaster. There is no question that public enterprise has its same budget problems as private economy does. There is a tremendous recession abroad in the land, and families in our districts are trying to balance their budget as are mayors and county executives and State executives.

However, when laws were written some years back to protect those who are unable—either because they are powerless or unsophisticated or such a small segment of the marketplace—to protect their own retirement funds from outright thievery, from just incompetence and/or from very sophisticated schemes to reduce their justly earned pensions, we put in place some laws that would, in fact, protect the average American from just such a scheme. We didn't do a good job. We left some loopholes. We anticipated that public officials somehow would be more trustworthy than private officials. In the other body today they are going to discuss that at some length. I suppose it is the shame of California that we deal with savings and loan scoundrels, that we house in our Ivan Boesky Tennis Ranch, Mr. Milken, at government expense as he is on a paid vacation, and that this may be the genesis of a scheme to rob public employees of their pensions. And I am ashamed for my State that it may have started there. In any event, the time has come, I think, to correct it.

The governor of California not only took money to which he was not entitled, but now he is trying to sack the bankers, the California Public Employees Retirement System Board, because they were too responsive to the employees and not responsive enough to the employer. Now, ERISA protects private pension plans from employer raids; indeed has criminal sanctions. Public employees have no such protection as I have stated. Public employers are subject to taxpayer and press scrutiny, and State laws were thought to prohibit public employers from engaging in the type of behavior that is banned in the private sector by ERISA.

A recent experience with the Calpers, fund shows that our belief in this public system was ill-founded. In fact, Governor Wilson has earned high marks by some who would mimic his budget solution and further endanger workers across the country. Now, while the workers and the retirees are battling this California Employees Retirement System raid in the Court, we have to determine, I think, how widespread this problem is across the country. It may be de minimis. It could be that workers 20 to 30 years from now won't suffer $3-$4 a month reduction in very generous pension plans. That is a great leap of faith, I think, to suggest that that is all that these underfunding budget schemes will do. But that may be the fact, and we should determine those facts as best we can.

I want to thank Congressman Roybal who shares our interest in this issue and is concerned. And his subcommittee's concern is the protection of the elderly and the retired. And we do know the impact of the fiscal pressures felt by States on the integrity of the pension trust funds, and we have to find out what role, if any, the Federal government should play in protecting the security of our public work force. I look forward to hearing the statements of our witnesses and extend a special welcome to my constituent, Arnold Schneider, who is the Executive Director of the American Association of Classified School Employees. And we will hear from him later. Mr. Chairman, I yield to any other opening statements.

Chairman ROYBAL. All right. The Chair will now recognize Mr. Rinaldo.

STATEMENT OF REPRESENTATIVE MATTHEW J. RINALDO

Mr. RINALDO. Well, thank you, Mr. Chairman. I want to take this opportunity to commend you and Chairman Stark for calling this hearing to examine the impact of State and local budget decisions on the pensions of public employees. With fiscal problems mounting, public retirement trust funds have become a tempting way for many State and local governments to balance their budgets. Since any diversion of funding can mean sharply reduced benefits for retired employees, this is clearly a serious issue that must be addressed. State and local governments have a clear, contractual obligation to ensure that pension benefits will be available to State employees at retirement age. Any decisions over State pension plans must start from that premise. Diverting funds away from retirement systems may seem tempting, but it involves choosing between today's needs and tomorrow's obligations. And there is no indication that tomorrow's taxpayers will be any better prepared to support these obligations.

In some States, the public employees retirement systems have been prudently managed and conservatively funded. And even though State budgets have been hard hit by the recession, many States have continued to appropriate adequate funding to ensure that retirement systems remain secure.

Mr. Chairman, I want to commend you once again for calling this hearing. I think it is particularly important. As I mentioned, it is a serious issue. And I regret that, unfortunately, I have to leave for an important markup of the Full Energy and Commerce Committee. But I want to State that I look forward to working with you and Chairman Stark, my other colleagues on this important issue in an effort to resolve it so that State and local employees are treated in the manner that they should be, and their pensions are given the protection that they deserve. I yield back the balance of my time.

Chairman ROYBAL. All right. Thank you, Mr. Rinaldo. The Chair now recognizes Ms. DeLauro.

STATEMENT OF REPRESENTATIVE ROSA L. DeLAURO

Ms. DELAURO. Thank you, Mr. Chairman, and I want to thank Chairman Stark as well for conducting these hearings. These are very tough economic times in America and particularly in my

State of Connecticut. We have been suffering the brunt of this recession for more than 2 years now, and the people of my State are hurting.

State and local governments are also struggling under this pressure. Our governor announced on Monday that the State will have a deficit in addition to what it has—another shortfall of about $175 million. He has recommended dealing with this piece of the deficit by making additional cuts in services and by postponing the State's contribution of $70 million to the Teachers' Pension Fund.

Connecticut's plight is not unique, and today we will hear about other States who are facing similar difficulties. Over the past decade, the Federal Government has dramatically reduced its support to States. Fiscal pressures tempt State and local governments to eye public pension funds as a source of budget relief. To governments desperately trying to balance a budget, these funds are very enticing. They offer the prospect of millions of dollars of unallocated funds.

These pension funds are not open accounts, but they really are a sacred trust. They represent the hopes and the dreams of workers who have spent their entire lives saving for retirement. When States dip into these pension plans, they compromise the integrity of the funds. A retiree who was promised benefits should receive every penny that he or she deserves, and as States amass debt owed to these funds, the prospect that they could default on these obligations becomes increasingly real.

I have seen what can happen when pension funds are not properly managed. In May, former employees of Rebestos Industries in Stratford, Connecticut, were notified that as a result of the failure of the insurance company holding their pensions, they would receive only 70 percent of their monthly pension checks. The case is now in Court, and I sincerely hope that full benefits will be restored. But it took the convening of a Government Operations Subcommittee and endless effort on the part of the pensioners to ensure that these retirees receive what they deserve. I sincerely hope that State and local employees will never have to face the loss of their full pensions. I don't want Congress to have to fight tooth and claw to restore the pensions of Connecticut teachers or California State employees.

But at the current rate of borrowing from these pension plans, State and local government will soon owe billions of dollars to these plans. And when the pensions come due, many will want to reduce individual pensions rather than pay the billions owed. This will be a great temptation, but let this hearing serve as notice that we will expect these promises to be kept and the full pensions to be paid. Mr. Chairman, I congratulate you on calling these hearings before the pension borrowing gets out of control. Your prescience may save millions from the pain and the agony that was experienced by the Rebestus retirees in my own district. Thank you very much, Mr. Chairman.

Chairman ROYBAL. The Chair recognizes Mr. Boehlert.

STATEMENT OF REPRESENTATIVE SHERWOOD L. BOEHLERT

Mr. BOEHLERT. Thank you very much, Mr. Chairman. Mr. Chairman, I hope we all can take the pledge here this morning. As Chairman Stark has indicated, we are somewhat delinquent in addressing this subject, but better late than never. But I will be the most disappointed Member of this body if a year from now we are still discussing this subject. I think it is fairly easy to ascertain the facts, to identify the problem, and it should be fairly easy to develop a solution. And so I, for one, am hopeful that all of my colleagues here will take the pledge along with me that we are going to have less words and more deeds and get moving with this. Thank you very much.

Chairman ROYBAL. Thank you. Mr. Swett.

STATEMENT OF REPRESENTATIVE DICK SWETT

Mr. SWETT. Thank you, Mr. Chairman. I am here today to learn more about the use of public pensions to balance State and local budgets. The population of this country continues to grow at an unprecedented rate, and I am sure that although pensions today are important, they will be continually more important in the years to come. The State of New Hampshire, my home State, is in a very similar situation, if not worse situation, than the State of Connecticut. And many of the words that Rosa DeLauro has mentioned about her home State apply to New Hampshire. We are looking at 10 percent of our budget deficit or a $200 million deficit back home, and it is always tempting to cherry pick out of these types of funds. I think that it is a very responsible action that this select committee be meeting to discuss this situation.

I compliment you, Mr. Chairman, and Chairman Stark for holding a joint committee hearing on this very critical issue, and I hope that by the time we finish with this discussion, as my distinguished colleague, Congressman Boehlert, has said, we will have accomplished more than just words. We will have stemmed the flow of irresponsible use of these funds and will have hopefully cauterized the system so that those who have paid in to receive pensions as they reach their sunset years will rightfully be able to collect on those investments they made during their working years. Thank you very much, Mr. Chairman.

Chairman ROYBAL. Thank you. Mr. James.

STATEMENT OF REPRESENTATIVE CRAIG T. JAMES

Mr. JAMES. Mr. Chairman, I am going to be most interested in hearing and reading the testimony, that I won't be able to be here for the entire hearing. But what I think the issue will have to revolve around is to what extent the States have a contractual relationship with the individual employees in relationship to whether it is the fund, or their general taxing power is pay as you go. It amazes me that when a State does have taxing power you would even consider that there not be a contractual relationship between the employee and the State where they would have a direct cause of action like any other beneficiary of a contract. And I assume though and I know that it some States it is not viewed that way. They can change the benefits as the Federal Government can. And under Social Security, there is no contractual guarantee that you will receive specific benefits. That unnerves me in relationship to the Federal Government too.

The employees should know if you presumably have a retirement plan and if Social Security is, then you should have a vested right at a certain point to certain returns. And when you take the tax code and you change it and say, "Okay. We are going to all of a sudden tax your Social Security," et cetera, that is very much a diminishment of your retirement plan, and we have done that here. So let us not be holier than thou in the context that we don't know how it is done. We have done it on this Federal level. We have diminished people that should have—if you looked at Social Security as a retirement plan, you would see that when you say all of a sudden we are going to tax you on it, you have reduced many people by a third—their purported retirement.

So every State, I am sure, has a different relationship with the fund. I can't imagine though that if there is a State law that says we will have a fund, et cetera, and they raid the fund, it would seem they would have the same contractual obligation to that fund as a private employer. At least there should be that minimal protection, but if they are representing to their employees they have a fund, they should not be able to mess with that fund if that is the way they fund it by statute. If they are on a pay-as-you-go plan, well, they have the taxing power, and as long as there is contractual obligation that specifies a formula, that shouldn't be able to be changed in relationship to a specific employee during his employment at least for that period of time that he has vested. So you should have a vested right at a certain point just like you would with any contract.

Even though your employment contract varies from year to year for the 10 years, the 15, or the 20 or the 30 that you put in, there should be a vested right. And if it is to be tied into a specific fund, then that fund should be managed prudently as we should mandate by law.

On the other hand, for future retirement benefits for additional years that have not yet been worked, of course you could not abrogate the right of the States to change their future retirement benefits. But to think that you could say, "Okay. We have a fund," and then raid it and rip it off and leave the employee without any benefits is really absurd whether it be on the Federal or the State level. So I think we have to turn the mirror on ourself and think likewise how we treat it and analyze what the States are doing to see if we do need legislation in this area to at least give them the minimal protections that you have in the private sector. You have a problem right now with Eastern Airlines—a major problem. What happens in the event of bankruptcy within proper funding and proper priorities. So all of these things I think we should look at, and I congratulate the Chairman on convening these hearings.

Chairman ROYBAL. Thank you. Mr. Houghton.

STATEMENT OF REPRESENTATIVE AMO HOUGHTON

Mr. HOUGHTON. Thank you. Chairman, I am delighted you are having these hearings. I am all ears. The question which I think comes foremost to my mind is what is the enforcement of the oversight if we find something is wrong? If we find something is not wrong, then everybody goes away and does their own thing. If there is something that is wrong and we should get into it, I think that might be clarified in the proceedings. Thank you very much.

Chairman ROYBAL. Thank you. Mr. Fish.

Mr. FISH. No comments.

Chairman ROYBAL. Thank you. Mr. Nichols.

Mr. NICHOLS. No comment at this time. Anxious for the hearings to begin. Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you very much. At this time, if there are no objections, I would like to submit the prepared statements of several Members for the hearing record. Hearing no objections, so ordered.

[The prepared statements of Representatives William J. Hughes, Jerry F. Costello, and Constance A. Morella follow:]

STATEMENT OF

THE HONORABLE WILLIAM J. HUGHES, CHAIRMAN SUBCOMMITTEE ON RETIREMENT INCOME AND EMPLOYMENT

BEFORE THE JOINT HEARING OF THE SELECT COMMITTEE ON AGING AND THE JOINT ECONOMIC COMMITTEE'S SUBCOMMITTEE ON INVESTMENT, JOBS AND PRICES

"USING PUBLIC PENSIONS TO BALANCE STATE AND LOCAL BUDGETS: THE IMPACT ON PUBLIC EMPLOYEES, RETIREES, AND TAXPAYERS"

WEDNESDAY, NOVEMBER 20, 1991

Throughout the 1980's, more than 2,000 companies terminated their defined benefit pension plans and removed more than $21.5 billion in assets, thereby draining forever a part of the reserves which were to be used to help pay promised benefits to hundreds of thousands of retirees.

Just one year ago, Congress attempted to limit this threat to the retirement security of private sector employees by including in the Omnibus Budget Reconciliation Act of 1990 an increase in the excise tax on pension asset reversions from 15% to 50%.

Now we are faced with a similar and serious threat to the security of teachers, maintenance workers, and public employees. An increasing number of cash-strapped state and local governments are raiding public pension funds.

This raiding of state and local pension funds is often nothing more than an accounting gimmick designed to take promised benefits from workers and retirees in order to pay for other government services. Ultimately these accounting deceptions may well end up being very costly to both the taxpayer and the retiree if budget shortfalls and decreased revenues due to the recession continue.

Just like the massive reversions in the private sector, these pension raids could jeopardize the ability of states and localities to pay earned benefits to retirees in the future, while undermining the confidence of workers that they will receive the benefits they have been promised when they retire.

Unlike protections for plans in the private sector, however, public plans are not covered by the federal Employee Retirement Income Security Act (ERISA). Rather, they are subject to requirements which vary from jurisdiction to jurisdiction. I look forward to today's discussion of possible comprehensive protections for public pension plans.

I firmly believe that this problem is also indicative of the fact that the nation lacks a coherent retirement income policy. Testimony before my Subcommittee on Retirement Income and Employment reveals that, unless we begin to address these problems now, we face a looming crisis in adequately supporting our growing numbers of older Americans.

Less than half of today's full-time workers are covered by an employer-sponsored pension plan. I am greatly concerned that if these trends continue, by the year 2020 the majority of the 50 million Americans aged 65 and over will have little more than Social Security as a source of retirement income.

Substantial testimony before my Subcommittee reveals that over the past decade the burden of saving and investing for retirement has dramatically shifted from the employer to the employee. Consequently, in addition to the tens of millions of workers who are not covered by a pension plan, millions more are not participating in the types of defined contribution plans that are now emerging. What is more, a survey we conducted jointly with the American Society on Aging reveals that even well-educated individuals often lack the knowledge and information needed to effectively manage and understand their pension plans.

Americans are often correctly informed that Social Security alone will not be enough to get by in retirement. Yet, our current policies often penalize retirees who earn more than one source of retirement income.

For instance, of those medium and large employers who offer a defined benefit plan, more than three out of five retirees have up to half of their pensions reduced by their Social Security benefit. In addition, many women who work and pay Social Security taxes are finding that their benefits are no larger than if they had never worked a day in the paid labor force because their earned benefits are completely offset by their husband's benefits. Finally, many teachers and government workers are subjected to a government pension offset which completely eliminates their Social Security spousal benefit in 90% of the cases.

Unless we correct these policies soon, a growing number of middle class Americans who have worked all their lives will be forced to struggle with incomes below or near the poverty level when they reach retirement age.

I look forward to today's testimony and commend Chairmen Roybal and Stark for convening this important hearing.

JERRY F. COSTELLO
21ST DISTRICT, ILLINOIS
119 CANNON BUILDING
WASHINGTON, DC 20515-1321
TEL: (202) 225-5661
FAX: (202) 225-0285
1316 NIEDRINGHAUS AVENUE
GRANITE CITY, IL 62040
TEL: (618) 451-2122
FAX: (618) 451-2126
8787 STATE ST., SUITE 207
EAST ST. LOUIS, IL 62203
TEL: (618) 397-8833

Congress of the United States
House of Representatives
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OPENING STATEMENT BY U.S. REP. JERRY F. COSTELLO

HOUSE SELECT COMMITTEE ON AGING

"USING PUBLIC EMPLOYEE PENSIONS TO BALANCE STATE AND LOCAL BUDGETS: THE IMPACT ON PUBLIC EMPLOYEES, RETIREES AND TAXPAYERS"

NOVEMBER 20,1991

MR CHAIRMAN, I AM PLEASED TO BE HERE TODAY AS THE HOUSE SELECT COMMITTEE ON AGING DISCUSSES THE CURRENT EFFORTS BY SOME STATE AND LOCAL GOVERNMENTS TO DIVERT PUBLIC PENSION FUNDS FOR GENERAL REVENUE PURPOSES, IN ORDER TO REMEDY BUDGET PROBLEMS. I LOOK FORWARD TO HEARING THE EXPERT TESTIMONY OF OUR DISTINGUISHED PANEL OF WITNESSES, AND I THANK THEM FOR COMING.

I AM DEEPLY CONCERNED BY WHAT SEEMS TO BE AN INCREASING TREND BY LOCAL AND STATE GOVERNMENT OFFICIALS TO BALANCE THEIR CURRENT BUDGETS BY DRAWING MONEY FROM OR SLASHING CONTRIBUTIONS TO THEIR PENSION FUNDS. TEACHERS AND OTHER PUBLIC EMPLOYEES MUST BE ABLE TO HAVE CONFIDENCE IN THEIR RETIREMENT SECURITY.

BY USING THESE PENSION FUNDS AS A SHORT-TERM SOLUTION TO CURRENT BUDGET PROBLEMS, LOCAL GOVERNMENT OFFICIALS ARE ONLY DELAYING, AND POSSIBLY CAUSING MORE FINANCIAL DIFFICULTIES IN THE LONGRUN.

THESE DIFFICULTIES COULD VERY WELL HAVE A NEGATIVE IMPACT ON FUTURE TAXPAYERS AND THOSE WHO DEPEND ON PUBLIC PENSIONS.

IT IS MY HOPE THAT THIS HEARING WILL BRING ABOUT A BETTER UNDERSTANDING OF THIS PROBLEM AND FACILITATE LEGISLATIVE SOLUTIONS TO PREVENT FUTURE PENSION RAIDS.

AGAIN, MR. CHAIRMAN, THANK YOU FOR CALLING THIS INPORTANT HEARING.

CONSTANCE A. MORELLA
8TH DISTRICT, MARYLAND

COMMITTEES:
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SELECT COMMITTEE ON AGING

Constance A. Morella

WASHINGTON OFFICE:
1024 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-5341

DISTRICT OFFICE:
11141 GEORGIA AVENUE
SUITE 302
WHEATON, MD 20902
(301) 946-8801

Congress of the United States
House of Representatives

Opening Statement
The Honorable Contstance A. Morella

Select Committee on Aging and The Joint Economic Committee's Subcommittee on Investment: "Using Public Employee Pensions to Balance State and Local Budgets: The Impact on Public Employees, Retirees and Taxpayers."

November 20, 1991

Thank you for scheduling this hearing and allowing us this opportunity to review the issues related to the use of public employee pension funds to balance state and local budgets. So often we grapple over financial support for our seniors -- who should pay and how much? Yet today, we are discussing funds set aside by individuals themselves planning for their own financial security in retirement. For this reason, it is critical that we address concerns and discuss alternatives to assure the safety of those finances and the welfare of our public employees.

Benefiting from sound investments in the 1980s, state and local governments believe many of their public pension funds have ample monies to meet retiree payments, even if present contributions are reduced. Among other fudiciary stategies, we have seen state and local governments raising investment-return assumptions, thus lowering their required contributions, and borrowing directly against those pension funds. As public pension funds are not subject to the protections of ERISA, the Employee Retirement Income Security Act, I feel it is important to discuss measures which may be necessary to assure sound management of these funds.

I would like to thank our distinguised panelists for coming today to address the issues related to the use of public employee pension funds. While not losing sight of state budgetary needs and independence, I think we are taking an important first step in addressing the long-term financial security of our public employees.

Chairman ROYBAL. The committee will now proceed then and ask the following witnesses to come forward. On panel number 1, Ms. Dawn Clark Netsch, Mr. Anthony J. Solomon, and Mr. Joe Wyatt, Jr. Will you please take your respective seats?

Chairman STARK. I would like to ask the distinguished co-Chair and the members of the panel if it would be agreeable with them if we request the witnesses during the course of the proceedings to attempt to summarize or expand on their written testimony in, approximately, 5 minutes or more because that will give us more time to inquire of them and perhaps follow along the lines that would be of help to the committee. Would that be satisfactory? And if there was an objection from the panel, I would just ask the witnesses in the room if they would attempt as they could to summarize their prepared testimony, and we would then look forward to inquiring of them for further information. Thank you, Mr. Chairman.

Chairman ROYBAL. All right. Without objection then, the entire written testimony will appear in the record following a summary by each member of the panel. The Chair will recognize Ms. Netsch please.

STATEMENT OF DAWN CLARK NETSCH, COMPTROLLER, STATE OF ILLINOIS

Ms. NETSCH. Chairman Roybal and Chairman Stark and members of the committee, thank you very much for the invitation first and the opportunity to testify on a subject that I think is of enormous interest and concern to many of us in State government. I am the elected comptroller of the State of Illinois, and before that I was a member of the Illinois Senate for some 18 years. And in that connection, I co-chaired the Economic and Fiscal Commission which, for a period of time, has had general oversight over the State pension systems. I might digress by saying that my co-chair for some time was Tom Ewing who is now a Member of Congress from the State of Illinois, and we had a great working relationship. I have been actively involved in the subject of pension funding from my perspective primarily as a State legislator. I have a written statement which I have given you copies of, and I will attempt to summarize some of my main points.

One, just a brief note on the structure of the Illinois pension system. We have about 560 separate local government pension systems most of them police and fire. At the State level, there are five systems, and those are the ones that I will be particularly directing my attention to because that is, obviously, where our jurisdiction is. I suppose you could say that there is sort of more than one way to skin a cat because I think our concern in Illinois is not so much dipping into the existing pension fund or mismanaging or trying to take over control. Our major concern is underfunding. At no point have we put into the pension fund the employers' share as it ought to have been computed and contributed to those pension funds which means that we have been effectively, if you will, stealing from our pension funds but only by underfunding. And that can be just as serious as any other form.

We have one immediate question of borrowing from the pension fund, if you will, and that may be one reason why Illinois was asked particularly to present our situation. We have in addition to the appropriations from the general funds that make up most of the pension support, we have one earmarked "Dedicated Fund" which is the source for which is unclaimed property, what we used to call property that has escheated to the State of Illinois. It sits for a short while in an unclaimed property fund. It then transfers automatically to something that is called the pension fund, and by statute, it then moves into the five pension systems by annual appropriation.

This year for the first time the governor has directed me as the comptroller to take $21 million out of that pension fund and give it generally to the State's general funds for general purposes. I regret to say that I told the governor I didn't want to do it and made a terrible scene about it, but I probably had no legal authority not to make the transfer. Happily, I was saved at the eleventh and a half hour by a Court injunction, and that matter is currently pending in the Illinois Supreme Court. That is the first time we have actually, I think, dipped into the existing sources of funding. But as I indicated, what we don't do is we don't fund our pension system.

I think if you will look at the chart on page 2 of my statement, you will see that all together our five State pension systems are underfunded to the tune of about $10.5 billion. And in recent years, the last 3 years in particular, we have been contributing the employers' share at not any basis of actuarially determined contribution but just whatever the governor chose to suggest ought to be put into the pension funds. We do not have an actuarial base to the contribution that is made by the employer, the State of Illinois, to those pension funds. That is despite the fact that we passed a law in 1989 that for the first time committed the State to a very sound method of funding its pension systems. It was an actuarial-based determining the current cost of benefits earned for the base for it and then a 40-year amortization of the unfunded liability which would have allowed us at the end of the 40-year period at least to begin to catch up to the amount we should have in those pension funds. After some years of difficulty, we did finally get that passed and signed by the governor, and it has never been funded since then, not one bit. So that we are no better off than we were before, unfortunately.

Our funding ratio, I believe, is probably among the lowest of the States in the country. I have seen one other formula that was worked out that suggested that we are among the lowest in our funding ratio. As you see for the five together it is 57.8 percent which is not very good at all. The only reason why it is even at that level is that our investments have really done very well. We have no quarrel that we are aware of anyway with the way in which the investments are handled, and we made good money particularly during the years of high interest rates and high returns. And apart from that, our funding ratio would be in even much worse shape than it is right at the present time. But our trend, of course, is all in the wrong direction, and that trend is a reduced employer contribution, a reduced funding ratio, and, obviously, very big trouble ahead.

I might quickly mention one other thing. We do have in Illinois, and I had something to do with this also because I was also a delegate to our constitutional convention, 1970, not 1870 by the way—we do have in our State constitution a provision which I think is still fairly unique which does provide that public pension benefits are enforceable, contractual relationships the benefits of which shall not be diminished or impaired. So there is some State constitutional protection for our retirees. I think what it really means is, and I will just summarize this now quickly, that we are doing one of two things. We either are putting ourselves in a position where future retirees are going to have to have diminished benefits, that is, benefits that are lesser than those who are currently in the system because they are not yet protected, or we are putting off on future generations, and I think this we are doing in any èvent, a very major financial burden.

And it is particularly true if our constitution is more of a protection than is generally available to retirees, then we are going to have to meet the obligations at least as they become earned and vested, and we are not funding it at a level where we are going to be able to keep that up. And that means enormous financial implications for those who come after us, and I think that is just as serious as some of the other kinds of problems that the members of the committee and you have mentioned.

[The prepared statement of Ms. Netsch follows:]

OPENING STATEMENT OF DAWN CLARK NETSCH
Comptroller, State of Illinois
November 20, 1991

Introduction

Chairman Roybal, Chairman Stark and members of the committees, I would like to thank you for the invitation to address the Joint Hearing of the House Select Committee on Aging and the Subcommittee on Investment, Jobs and Prices of the Joint Economic Committee. I have been invloved in State finance in Illinois for many years and am grateful for the opportunity to discuss how Illinois budgetary problems have affected our retirement systems.

Before proceeding with my specific remarks, let me share with you some of my background in Illinois public finance. I was a member of the 1970 Constitutional Convention that rewrote the State's previous Constitution, which had been in effect since 1870. (The 1970 Constitution recognizes public pension benefits as a contractual obligation and provides that they cannot be impaired or diminished.) Much earlier, as part of the Governor's staff, I worked on legislation that dedicated the State Pensions Fund, a special fund in the State Treasury which receives money from unclaimed property at financial institutions, as a source of additional money for the State-funded retirement systems in an effort to help reduce their unfunded liabilities. As a State Senator for 18 years, I served as the chair of the Senate Revenue Committee and I have also served, with Congressman Tom Ewing, as a co-chair of the General Assembly's Economic and Fiscal Commission, which is similar to your Congressional Budget Office. In 1985, the Commission was given pension oversight responsibilities and has been active in both reporting on the financial condition of the State's pension systems and in preparing and reviewing legislation on pension funding. As State Comptroller, I am an ex officio Trustee of the State Employees Retirement System.

Introduction-Illinois Public Pension Systems

Illinois has over 560 public employee pension systems, of which over 540 are locally-funded police and fire systems. The State provides employer contribution for 5 systems:

Teachers' Retirement System (excluding Chicago)
State Universities Retirement System
State Employees Retirement System
Judges Retirement System
General Assembly Retirement System

Comptroller Netsch
page 2

FY 1990 FINANCIAL STATISTICS
(millions of dollars)

	accrued liability	net assets	unfunded liability	funded ratio	benefic./ partic.
TRS	13,662	8,080	5,583	59.1%	147,245
SURS	6,238	3,300	2,938	52.9%	73,098
SERS	4,538	2,795	1,743	61.6%	113,205
JRS	366	167	199	45.6%	1,425
GARS	79	33	46	41.8%	508
total	24,884	14,375	10,509	57.8%	335,481

Basic Trends

The figures above provide a "snapshot" of where the systems stood on June 30, 1990. But looking at just the end of one year's valuations can be misleading and so it is necessary to look at the trends over time. While funded ratios can change for a variety of reasons, they do give some basic insights to the performance of the five State pension systems over the past several years. Up until FY 1988, the funded ratios for the five systems had been steadily increasing. Then, in FY 1988 and again in FY 1990, the funded ratios fell and we expect that they will decline again in FY 1991 and FY 1992.

The Teachers' and State Universities Retirement Systems manage their own investments. From 1981 through 1991, Teachers' experienced investment returns below 9.2% in two years and returns of 14.4% or better in four years. Similarly, State Universities' return on investments fell below 7.8% only once and were 16.3% or higher in four years. The State Board of Investments, which manages the assets of the other three systems, had three years with returns of 2.5% or less and four years with returns of 14.3% or better. The problem with the five State retirement systems is not on the investment side. Indeed, if not for several years of above average investment returns, the systems would have been in even worse shape. No, the crisis in Illinois State pension systems is in underfunding.

A recent study by the Illinois Economic and Fiscal Commission attempted to allocate the just under $1.5 billion growth in the systems' unfunded liabilities to various factors--investment returns, salary growth, employer contributions, plan amendments, changes in actuarial assumptions, and miscellaneous factors--over the period from FY 1985 through FY 1989 for the Teachers', Universities, and the State Employees systems. Although investment income was $1.7 billion above the assumed rate of return, employer contributions were more than $2.2 billion below what would have been required under normal cost plus interest (the contribution needed to keep the unfunded liability from growing).

Comptroller Netsch
Page 3

The basic problem is that the systems are not and have not been funded on an actuarial basis. From FY 1973 through FY 1981, the State contribution was set equal to 100% of benefit payout, on the assumption that both employee contributions and investment would be invested to provide for future benefits. When Illinois went into the recession in the early 1980s, one of the casualties was the State's pension contributions.

In FY 1982, the aggregate contribution to the five systems was reduced to the equivalent of 62.5% of payout, one month's school aid payments were delayed, over $60 million was "borrowed" from other State funds, and $150 million was borrowed in the credit markets. For FY 1983, the Governor proposed a five-year phased-in return to 100% of payout and proposed a contribution equal to 70.0% of payout, but only 51.0% of payout was enacted. For FY 1984, the Governor proposed 77.5% of payout, but only 60.0% of payout was enacted and that became Illinois "funding policy" through FY 1987.

For FY 1988, the Governor proposed a $1.0 billion tax increase, but no increase in pension contributions over the prior year. When the legislature refused to pass the tax increase, he cut agency budgets across the board and took additional cuts out of the pension contribution, for a total reduction of over $60 million. The cuts were justified by claiming that the State "should share in the retirement systems' above average investment returns." (Two months later the stock market fell by over 500 points and the systems ended the year with investment returns of 2.5% or less.) The resulting appropriation was the equavalent of 44.0% of payout, and a "new" funding policy was implemented--at least for one more year.

The pension oversight work done at the Economic and Fiscal Commission while I was a co-chair convinced me of the need to address the long-term funding needs of the retirement systems. The systems were looking at essentially flat employer contributions. In 1987, 1988, and again in 1989, I sponsored legislation that would have changed Illinois ad hoc funding policy to one that would be based on an actuarial funding method known as 40-year level percent amortization. The Governor finally consented to sign the legislation, provided that it would have a seven-year phase-in in order to minimize the impact on appropriations, and Senate Bill 95 became law in the Spring of 1989.

While it would have allowed the State to address the pesnion funding issue in a rational and systematic manner, Senate Bill 95 has had little effect because it has been underfunded every year since enactment. In the first year, the shortfall was $34 million, last year, it was $104 million, and this year it is an estimated $225 million. The FY 1990 appropriation was only increased by $30 million, despite a first year cost of $64 million. In FY 1991, the

Governor recommended no increase in overall contributions by reducing the General Funds appropriation by $30 million and increasing distributions from the State Pensions Fund by a like amount.

This year, under a new administration, the Governor recommended no increase in General Funds contributions and restored the State Pensions Fund distribution to its FY 1990 amount--essentially cutting contributions by $30 million at a time when the cost of the third year of the seven-year phase-in was $195 million more than had been appropriated in FY 1991. Based on the FY 1992 appropriation, we would estimate that pension appropriations would have to increase by around $325 to $350 million just to meet the fourth year of the phase-in and still would not address the shortfalls from the prior years.

State Pensions Fund

You should be aware of the relationship between the retirement systems and the State Pensions Fund, which has been mentioned earlier. Almost all of the State's contributions to the systems are appropriated from either the General Revenue Fund or the Common School Fund. Over the past five years, these contributions have averaged about $460 million. The State Pensions Fund, however, is not one of our main operating funds and contributes an average of from only $10 to $15 million per year. Growth in receipts to the State Pensions Fund since FY 1986 have allowed substantial surpluses to accumulate to the point where the FY 1991 distribution was $42.5 million, an increase of $30 million from FY 1990. Even with this large distribution, there was still a balance of over $30 million in the fund at the end of FY 1991.

Court Cases

Case law in Illinois has established that the State Constitution's protection of pensions applies only to benefits, but not to the funding that would be needed to provide for those benefits. This past Spring, however, a new suit was filed in State court to force the State to fund the retirement systems at the levels required under the provisions of Senate Bill 95. That suit is still before the courts.

In July, the "Governor's First Emergency Budget Relief Act" (Senate Bill 45) was signed. The bill contained a large number of provisions aimed at dealing with the State's deteriorating financial condition. One of the provisions authorized the Governor to transfer (not borrow) up to $50 million from other State funds into the State's main operating fund, the General Revenue Fund. As a trustee of the State Employees Retirement System, I was concerned about the possibility that the Governor might try to transfer money from the State Pensions Fund and joined with the other trustees in sending a letter from the Borad to the Governor calling upon him to not take money from the State Pensions Fund.

On July 31, 1991, the Governor ordered me to transfer $21 million from the State Pensions Fund into the General Revenue Fund. When that order became public, the plaintiffs in the Senate Bill 95 funding suit filed a second suit asking that my Office be enjoined from making that transfer. That suit is currently before the Illinois Supreme Court and the $21 million is still in the State Pensions Fund. I have called upon the Governor on numerous occaisions and suggested that the money be transfered from some other funds so that we can pay our rapidly growing pile of unpaid bills. He has refused to budge "on principle."

Summary

I was invited here today because of the suit over the Governor's attempt to transfer $21 million from the State Pensions Fund. While not a trivial issue, this suit is dwarfed by the larger issues that are at stake in how the State funds its pension systems, or, more accurately, underfunds its pension systems.

My concern is for the future health of our State retirement systems and for the deferral of obligations to future generations. Underappropriated pension contributions are like unpaid credit card bills. The liability does not go away just because you choose to not pay the bill when it is due. You still owe the unpaid balance, plus interest. Eventually, the cost of rectifying the problem becomes too great. Our problems might be more understandable if our retirement systems provided extravagant benefits, but they do not. We are having trouble facing our obligations for systems that have some of the lowest benefit levels in the country.

The five State-funded retirement systems in Illinois are at a crossroads, and the choices are not very appealing. Either we commit to increased and increasing appropriations to pay for the benefits that we already have, or we face the very real prospect of having to look at bringing our costs into line with what the State is willing to pay.

Chairman ROYBAL. Thank you.
Chairman STARK. Thank you.
Chairman ROYBAL. Mr. Solomon.

STATEMENT OF ANTHONY J. SOLOMON, GENERAL TREASURER OF RHODE ISLAND; ACCOMPANIED BY JOHN SIMMONS, DEPUTY TREASURER OF FINANCE

Mr. SOLOMON. Thank you very much. Thank you, Mr. Chairman, and members of the committee for the opportunity to appear before you today to discuss the future health of the Nation's public pension systems. The nature of the problem you are addressing today is immense, even in the Nation's smallest State, and I welcome the opportunity to tell Rhode Island's story. I have with me Deputy Treasurer of Finance, John Simmons, who will be here to answer any technical questions.

To help you understand the nature of the problem in Rhode Island, first let me help you understand our present situation. In the past 3 years, faced with mounting budget deficits, former Governor DiPrete and current Governor Sundlun have looked at the pension system to help resolve budget deficits. And legislators, faced with the political dilemma of higher taxes or raiding the pension fund, have chosen to go along with the raid on the pension funds to resolve short-term budget deficits while creating long-term problems.

Rhode Island has undergone two early retirement programs in the last 3 years. They have also experienced a change in the method of funding the pension system's unfunded liability. In addition, there have been adjustments of actuarial assumptions and deferred State contributions. These four programs will cost the State of Rhode Island Employees Retirement System, and the taxpayers, hundreds of millions of dollars over the next 25 years. These actions have reversed a process of reducing our unfunded liability to increasing it.

In the ratio of contributions to benefits, we are losing the battle month after month after month. In the first 10 months of this calendar year, payouts have exceeded contributions by $50.2 million. There are those who will tell you that early retirement programs work if they go according to plan, but often they don't. When former Governor DiPrete offered early retirement in 1990, his administration anticipated it would attract 400 additional retirees. Eventually, 2,100 members of the system took advantage of the early retirement program, and members of his administration admitted they made the program too sweet. The result was an estimated $130 million cost over the next 25 years.

And that was the former governor's second early retirement program. The year before, 1989, 800 State employees chose early retirement, again, adding millions of dollars in long-term costs. In 1989, the former governor also successfully proposed, over my objection, a change in the method used by the State to fund the unfunded liability of the Employees Retirement System. At that time, the State was in its 13th year of a 40-year bail plan to amortize this liability. More importantly, within the 1989 fiscal year, the

State was to make only its third principal payment on the liability payment that was to extend an additional 27 years.

The change in funding, from sum of the digits to level funding, substantially reduced the principal payments on the unfunded liability and transferred the burden of payments on the current taxpayers to future generations. The added cost, for this change alone, adjusted for inflation, will be $90 million over the next 25 years. By implementing this proposal, the system's unfunded liability will be $1.27 billion in the year 2000. That is $289 million higher or 30 percent greater than under the old method. A change in the actuarial assumption in 1990 from 7.5 to 8 percent resulted in a reduction in contributions by $12 million alone for teachers and State employees.

The current administration deferred State contributions to the pension system as yet another way of bailing out budget deficits. The results are $111 million in State contributions were not or will not be made for fiscal 1991 and fiscal 1992. If this practice were to continue, it will devastate the pension system in Rhode Island. But governors faced with short-term anticipated deficits continue to look to short-term solutions at long-term expense.

Neither the General Treasurer nor representatives of the retirement system are part of Rhode Island's budget process. While we may object to a particular proposal, it is the governor who presents his State budget to the legislature including recommendations relative to the State's funding of the pension system. And legislators faced with the alternative of immediate tax increases have been prone to acquiesce to raids upon this pension system as a more expedient political solution. But by implementing these plans, we are increasing taxes for future generations. How will the programs be funded tomorrow when it is our children and their children's burden? We are simply mortgaging their future.

Only because of prudent investments have we been able to remain stable. If it were not for our successful investments, the $2.8 billion Rhode Island pension system would be losing money. Currently, economists project a $60 million budget shortfall in Rhode Island for fiscal 1991-92 and up to a $200 million shortfall in fiscal '92 and '93. While I remain steadfast in my opposition to further raids on the pension system, I can anticipate another effort by the executive and legislative branches to somehow use the pension fund to help eradicate the budget deficit. The problem is not unique to Rhode Island, and I expect it will be repeated in State after State. I cannot underscore more the importance of your hearings, the attention you bring to this problem, and the need for definitive action, both locally and nationally.

Rhode Island's pension system, and those of every other State, municipal and agency, exists so that its members can retire with a sense of security and with dignity. We have seen in Rhode Island, and nationally, that the constant use of pension systems to bail out budget deficits has eroded the confidence of the members of the retirement system. The easiest resolution I know would be for Congress to adopt legislation, but I know these things can be more complicated, and you first need to resolve the constitutional issues.

You have taken it upon yourselves to explore in depth a growing and disturbing problem facing not only the members of these pension systems but future taxpayers. I commend you for undertaking this task, and I urge you to do what you can to help prevent pension funding raiding the future.

[The prepared statement of Mr. Solomon follows:]

Anthony J. Solomon
General Treasurer

Alfred S. Pertuso
Deputy General Treasurer

State of Rhode Island and Providence Plantations
TREASURY DEPARTMENT
OFFICE OF THE GENERAL TREASURER
PROVIDENCE

Testimony related to Public Pension Funds by Rhode Island General Treasurer Anthony J. Solomon Before the House Select Committee on Aging and Subcommittee on Investment, Jobs and Prices of the Joint Economic Committee November 20, 1991

Thank you Mr. Chairman and members of both committees for the opportunity to appear before you today to discuss the future health of the nation's public pension systems.

The nature of the problem you are addressing is immense, even in the nation's smallest state. I welcome the opportunity to tell Rhode Island's story.

Let me begin by introducing John Simmons, Rhode Island's deputy General Treasurer for Finance, who may be of assistance in answering technical questions members of the committee may have.

To help you understand the nature of the problem in Rhode Island, let me first help you understand our present situation.

In the past three years, faced with mounting budget deficits, former Governor DiPrete and current Governor Sundlun have looked to the pension system to help resolve budget deficits. And legislators, faced with the political dilemma of higher taxes or raiding the pension fund, have chosen to go along with the raid on the pension fund to resolve short term budget deficits, while creating long term problems.

Rhode Island has undergone two early retirement programs in the last three years. We have also experienced a change in the method of funding the pension system's unfunded liability. In addition there have been adjustments of actuarial assumptions, and deferred state contributions. These four programs will cost the state of Rhode Island Employees Retirement System - and the taxpayers - hundreds of millions of dollars over the next 25 years.

These actions have reversed a process from reducing our unfunded liability to increasing it.

In the ratio of contributions to benefits, we are losing the battle, month after month after month. In the first 10 months of this calendar year payouts have exceeded contributions by $50.2 million.

There are those who will tell you that early retirement programs work - if they go exactly according to plan. But often they don't. When former Governor DiPrete offered early retirement in 1990, his administration anticipated it would attract 400 additional retirees. Eventually, 2,100 members of the system took advantage of the early retirement program, and members of his

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administration admitted they made the program "too sweet." The result was an estimated additional $130 million cost over the next 25 years.

And that was the former governor's second early retirement program. The year before, in 1989, 800 state employees chose early retirement, adding millions of dollars in long term costs.

In 1989, the former governor also successfully proposed - over my objection - a change in the method used by the State to fund the unfunded liability of the Employees Retirement System. At that time, the state was in its 13th year of a 40-year payment plan to amortize this liability. More importantly, within the 1989 fiscal year, the state was to make only its third principal payment on the liability payment schedule that extended an additional 27 years.

The change in funding - from sum of the digits to level funding - substantially reduced the principal payments on the unfunded liability - and transferred the burden of payment from current taxpayers to future generations. The added cost, for this change alone, adjusted for inflation, will be $90 million over the next 25 years.

By implementing this proposal, the system's unfunded liability will be $1.27 billion in the year 2000, $289 million higher or 30% greater than under the old method.

A change in the actuarial assumption in 1990 from 7.5 percent to 8 percent, while actuarially acceptable, further reduced the state and teachers contributions by $12 million in that year alone.

The current administration deferred state contributions to the pension system as yet another way of bailing out budget deficits. The results are $111 million in state contributions were not made to the pensions in fiscal 1991 and will not be made to the pension system in fiscal 1992.

If this practice were to continue it will devastate the pension system in Rhode Island.

But governors faced with short term anticipated deficits continue to look to short term solutions at long term expense.

Neither the General Treasurer nor representatives of the Retirement System are part of Rhode Island's budget process. While we may object to particular proposals, it is the Governor who presents his state budget to the legislature, including recommendations relative to the state's funding of the pension system.

And legislators faced with the alternative of immediate tax increases, have been prone to acquiesce to raids upon the pension system as a more expedient political solution. But by implementing these plans we are increasing taxes for future generations. How will these programs be funded tomorrow, when it is our children's and their children's burden? We are simply mortgaging their future.

Only because of prudent investments have we been able to remain stable. If it were not for our successful investments, the $2.8 billion Rhode Island pension system would be losing money.

Currently, economists project a $60 million budget shortfall in Rhode Island for fiscal 1991-92 and up to $200 million in fiscal

1992-93. While I remain steadfast in my opposition to further raids on the pension system, I can anticipate another effort by the executive and legislative branches to somehow use the pension fund to help eradicate the budget deficit.

The problem is not unique to Rhode Island. I expect it will be repeated in state after state.

I cannot underscore more the importance of your hearings, the attention you bring to this problem, and the need for definitive action, both locally and nationally.

Rhode Island's pension system, and those of every other state, municipality and agency, exists so that its members can retire with a sense of security and with dignity.

We have seen in Rhode Island - and nationally - that the constant use of pension systems to bail out budget deficits has eroded the confidence of the members of the retirement system.

The easiest resolution would be for Congress to adopt legislation that would protect public pension funds from continuing to be a resource for budget bailouts. But I know these things can be more complicated and you first need to resolve the constitutional issues.

You have taken upon yourselves to explore in depth a growing and disturbing problem facing not only the members of these pension systems, but future taxpayers. I commend you for undertaking this task and I urge you to do what you can to help prevent pension fund raiding in the future. Thank you.

State of Rhode Island and Providence Plantations
OFFICE OF THE GENERAL TREASURER
STATE HOUSE
PROVIDENCE, RHODE ISLAND 02903
(401) 277-2397

Anthony J. Solomon
General Treasurer

April 11, 1991

Honorable Bruce G. Sundlun
State House
Providence, Rhode Island 02903

Dear Gov. Sundlun:

Comments by your budget director today indicated that your 1991-1992 budget contains a request to defer some $37 million in payments to the state Retirement System.

As you are aware, my main function as General Treasurer and Chairman of the state Investment Commission and Chairman of the Retirement Board is the protection of the fiscal integrity of the state Employees Retirement System.

We have both seen the erosion of the retirement fund by past actions. It is clear that any further deferment in pension payments will erode the Retirement System. You most recently publicly expressed concern about similar erosions to the system. This is a concern we both share.

Because of our ongoing concerns, I am asking our actuary to provide us with an analysis of the impact of a delay in payments, and I will share that with you immediately upon receipt.

I urge you to reconsider your position, and to work diligently with your budget office and the state legislature to find alternative funding.

Sincerely,

Anthony J. Solomon
General Treasurer

CC: Speaker Joseph DeAngelis
Majority Leader John J. Bevilacqua
Chairman and Members House Finance Committee
Chairman and Members Senate Finance Committee

State of Rhode Island and Providence Plantations
OFFICE OF THE GENERAL TREASURER
STATE HOUSE
PROVIDENCE, RHODE ISLAND 02903
(401) 277-2397

Anthony J. Solomon
General Treasurer

May 24, 1991

Representative Robert S. Tucker
Chairman, House Finance Committee
State House
Providence, Rhode Island 02903

Dear Chairman Tucker:

I have just received the actuarial report on the impact of the proposed withholding of contributions for teachers within the state Retirement System in fiscal 1991 and 1992.

You will see by the enclosed report that the longterm cost will exceed $23 million, placing a further tax burden on our future generations.

While I understand the budgetary problems, it is clear that your committee should look to other sources to address our financial shortfalls.

We can no longer look to the state Retirement fund as the bailout for budget problems. To do so would only be setting off a time bomb that will result in tremendous costs to future generations.

Sincerely,

Anthony J. Solomon
General Treasurer

c.c. House leadership
Senate leadership
Gov. Bruce G. Sundlun
Members State Retirement Board
Members State Investment Commission

State of Rhode Island and Providence Plantations
OFFICE OF THE GENERAL TREASURER
State House
Providence, Rhode Island 02903
(401) 277-2397

Anthony J. Solomon
General Treasurer

Dec. 19, 1990

Dear ~~Gov-Elect~~ Bruce Sundlun:

I have just reviewed the press accounts of Governor DiPrete's recommended budget cuts that include substantial changes within the pension system. I am adamantly opposed to the DiPrete proposal, which again looks to short term benefits at the expense of long term costs.

Over the last two years the governor has instituted programs that have reduced contributions to the pension system by more than $50 million, while continuing to offer early bonus and early retirement plans that provide greater benefits. Putting less money in the fund, while improving benefits, can only weaken the state's pension system.

We cannot continue to use the state pension system to bail out budget problems. The result can only mean a dismantling of a system upon which thousands of current and former state workers rely for a secure and dignified retirement.

The governor is once again proposing to transfer the burden from current taxpayers to future generations - to our children.

On Dec. 12 John Kane, Governor DiPrete's director of administration, asked the Retirement Board to undertake a study to see if the asset value for actuarial calculations can be changed. The board agreed to ask the Investment Commission and actuary to conduct this study.

No change can be considered without a thorough and responsible evaluation of the current and longterm impact of any change in the way assets are valued.

I am very sympathetic to the state's budget problems. But I am also quite aware that we cannot use the pension system to rescue the state budget. The members of the Retirement Board and Investment Commission have a fiduciary responsibility to ensure the longterm fiscal integrity of the pension system.

Sincerely,

Anth

Anthony J. Solomon
General Treasurer

State of Rhode Island and Providence Plantations
OFFICE OF THE GENERAL TREASURER
STATE HOUSE
PROVIDENCE, RHODE ISLAND 02903
(401) 277-2397

Anthony J. Solomon
General Treasurer

April 26, 1989

Rep. Robert S. Tucker, chairman
House Finance Committee

Dear Representative Tucker:

I would like to thank the members of the House Finance Committee for the time extended to me here today.

Presented before you today is a proposal to modify the financing method used by the State to fund the unfunded liability of the Employees Retirement System. Presently, the state is in the 13th year of a 40-year payment plan to amortize this liability. More importantly, within the 1989 fiscal year, the state will make only its third principal payment on the liability payment schedule that extended for an additional 27 years.

The proposal included within the Governor's Budget for 1990, modifies the funding method to substantially reduce principal payments on the unfunded liability. I would point out that inherent in this change is the transfer of the burden from current taxpayers to those future taxpayers - our own children. I would ask this committee if it is equitable to defer this debt payment, incurred during previous generations and force the payment onto future generations. This proposal is comparable to constructing a building in 1950 and asking taxpayers of 1990 to finance it.

I would like to take a moment to review the proposal's financial facts.

First, let's review the actual and present value cost of the proposal. As shown in detail in exhibit A, attached to this letter, by postponing the payment the unfunded liability, the added actual cost to all taxpayers will be $447,171,100. Taking into account an inflation factor of four percent, the present value added cost is equal to $90,384,000.

Second, let's review the impact on the unfunded liability under the proposed payment schedule. As shown in detail in Exhibit B, in implementing the proposal the unfunded liability in 1994 will be $1,238,561,400, which is $120,294,300 higher or 11% greater than that under the present method. In the year 2000, the liability amounts to $1,267,825,900, which is $289,027,100 higher or 30% greater than under the present method. I would also point out that under the proposed funding method, the unfunded liability actually increases annually through the year 2000.

Based on this analysis, I am recommending to the Committee that the State retain its current program of funding the Employees Retirement System, and exclude this funding proposal from the governor's budget for 1990. To detrimentally impact the integrity of the Retirement System is not in the best interest of the State especially in light of the fact that the savings associated with the proposal only occurs in fiscal year 1990.

I would suggest that the governor and the General Assembly look elsewhere to find funding sources to resolve the current budget problem.

Again, I appreciate the opportunity to speak on this important issue affecting the State of Rhode Island.

Sincerely,

Anthony J. Solomon
General Treasurer

c.c. members of the House Finance Committee

RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - STATE

EFFECT OF CHANGING TO PERCENT OF PAYROLL FUNDING

		ACTUAL DOLLARS		INFLATION ADJUSTED DOLLARS	
	YEAR	REDUCTION OR INCREASE IN COSTS		REDUCTION OR INCREASE IN COSTS	
1	1990	(10,339,000)		(9,941,400)	
2	1991	(10,072,400)		(9,312,500)	
3	1992	(9,696,700)		(8,620,400)	
4	1993	(9,211,700)		(7,874,200)	
5	1994	(8,615,600)	REDUCED COSTS	(7,081,400)	REDUCED COSTS
6	1995	(7,906,700)		(6,248,800)	
7	1996	(7,083,300)	81,849,500	(5,382,800)	67,594,300
8	1997	(6,143,600)		(4,489,100)	
9	1998	(5,085,500)		(3,573,000)	
10	1999	(3,907,200)		(2,639,600)	
11	2000	(2,606,500)		(1,693,200)	
12	2001	(1,181,300)		(737,900)	
13	2002	370,600		222,600	
14	2003	2,051,600		1,184,800	
15	2004	3,864,100		2,145,600	
16	2005	5,810,700		3,102,400	
17	2006	7,893,900		4,052,500	
18	2007	10,116,500	INCREASED COSTS	4,993,800	INCREASED COSTS
19	2008	12,481,400		5,924,200	
20	2009	14,991,400	245,663,300	6,841,900	100,694,900
21	2010	17,649,600		7,745,200	
22	2011	20,459,200		8,632,900	
23	2012	23,423,700		9,503,600	
24	2013	26,546,300		10,356,300	
25	2014	29,830,700		11,190,000	
26	2015	33,280,600		12,004,000	
27	2016	36,893,000	NET INCREASE	12,795,100	NET INCREASE
	TOTALS - - - -	163,813,600	163,813,600	33,100,700	33,100,700

RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - TEACHERS

EFFECT OF CHANGING TO PERCENT OF PAYROLL FUNDING

		ACTUAL DOLLARS		INFLATION ADJUSTED DOLLARS	
	YEAR	REDUCTION OR INCREASE IN COSTS		REDUCTION OR INCREASE IN COSTS	
1	1990	(17,913,700)		(17,224,700)	
2	1991	(17,443,600)		(16,127,600)	
3	1992	(16,785,800)		(14,922,500)	
4	1993	(15,939,400)		(13,625,100)	
5	1994	(14,901,700)	REDUCED COSTS	(12,248,100)	REDUCED COSTS
6	1995	(13,669,800)		(10,803,400)	
7	1996	(12,240,500)	141,520,600	(9,301,800)	116,896,900
8	1997	(10,610,700)		(7,753,100)	
9	1998	(8,777,000)		(6,166,600)	
10	1999	(6,736,100)		(4,550,700)	
11	2000	(4,484,300)		(2,912,900)	
12	2001	(2,018,000)		(1,260,400)	
13	2002	666,800		400,500	
14	2003	3,574,000		2,063,900	
15	2004	6,707,900		3,724,700	
16	2005	10,072,800		5,377,900	
17	2006	13,673,200		7,019,500	
18	2007	17,513,900	INCREASED COSTS	8,645,300	INCREASED COSTS
19	2008	21,599,700		10,252,100	
20	2009	25,935,700	424,878,100	11,836,700	174,180,100
21	2010	30,527,300		13,396,400	
22	2011	35,379,900		14,928,700	
23	2012	40,499,300		16,431,600	
24	2013	45,891,400		17,903,200	
25	2014	51,562,400		19,341,900	
26	2015	57,518,800		20,746,400	
27	2016	63,755,000	NET INCREASE	22,111,300	NET INCREASE
TOTALS - - - -		283,357,500	283,357,500	57,283,300	57,283,300

RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - STATE

	YEAR	PAYROLL	UNFUNDED LIABILITY	PAYMENT BY SUM OF DIGITS METHOD: PRINCIPAL	INTEREST	TOTAL ASSUMING PAYMENT AT MID-YEAR	IN 1989 $'S (4% INFLATION)	PAYMENT AS % OF PAYROLL
1	1990	400,413,000	430,562,200	3,651,600	30,039,000	34,954,000	33,609,600	8.729
2	1991	418,431,600	426,910,600	4,598,100	29,784,500	35,671,900	32,980,700	8.525
3	1992	437,261,000	422,312,500	5,543,800	29,463,700	36,320,300	32,288,600	8.306
4	1993	456,937,800	416,768,600	6,489,600	29,076,900	36,900,200	31,542,400	8.076
5	1994	477,500,000	410,279,100	7,435,300	28,624,100	37,411,600	30,749,600	7.835
6	1995	498,987,400	402,843,800	8,381,000	28,105,400	37,854,600	29,917,000	7.586
7	1996	521,441,900	394,462,800	9,326,700	27,520,700	38,229,100	29,051,000	7.331
8	1997	544,906,800	385,136,100	10,272,400	26,870,000	38,535,200	28,157,300	7.072
9	1998	569,427,600	374,863,700	11,218,100	26,153,300	38,772,800	27,241,300	6.809
10	1999	595,051,800	363,645,600	12,163,800	25,370,600	38,942,000	26,307,800	6.544
11	2000	621,829,100	351,481,700	13,109,600	24,522,000	39,042,700	25,361,400	6.279
12	2001	649,811,500	338,372,100	14,055,300	23,607,400	39,075,000	24,406,100	6.013
13	2002	679,053,000	324,316,900	15,001,000	22,626,800	39,038,800	23,445,700	5.749
14	2003	709,610,400	309,315,900	15,946,700	21,580,200	38,934,100	22,483,500	5.487
15	2004	741,542,800	293,369,200	16,892,400	20,467,600	38,761,000	21,522,600	5.227
16	2005	774,912,200	276,476,800	17,838,100	19,289,100	38,519,500	20,565,900	4.971
17	2006	809,783,300	258,638,600	18,783,800	18,044,600	38,209,500	19,615,700	4.718
18	2007	846,223,500	239,854,800	19,729,600	16,734,100	37,831,000	18,674,400	4.471
19	2008	884,303,600	220,125,200	20,675,300	15,357,600	37,384,100	17,744,100	4.228
20	2009	924,097,300	199,450,000	21,621,000	13,915,100	36,868,700	16,826,400	3.990
21	2010	965,681,600	177,829,000	22,566,700	12,406,700	36,284,900	15,923,000	3.757
22	2011	1,009,137,300	155,262,300	23,512,400	10,832,300	35,632,600	15,035,400	3.531
23	2012	1,054,548,500	131,749,900	24,458,100	9,191,900	34,911,900	14,164,700	3.311
24	2013	1,102,003,200	107,291,700	25,403,800	7,485,500	34,122,700	13,312,000	3.096
25	2014	1,151,593,300	81,887,900	26,349,600	5,713,100	33,265,000	12,478,300	2.889
26	2015	1,203,415,000	55,538,400	27,295,300	3,874,800	32,338,900	11,664,300	2.687
27	2016	1,257,568,700	28,243,100	28,243,100	1,970,400	31,346,500	10,871,500	2.493
TOTALS - - - - - - - - - - - - - - - -				430,562,200	528,626,900	995,158,700	605,940,400	

RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - STATE

PAYMENT AS PERCENT OF PAYROLL

	YEAR	PAYROLL	UNFUNDED LIABILITY	PRINCIPAL	INTEREST	TOTAL ASSUMING PAYMENT AT MID-YEAR	IN 1989 $'S (4% INFLATION)	PAYMENT AS % OF PAYROLL
1	1990	400,413,000	430,562,200	(6,787,500)	30,512,800	24,615,000	23,668,300	6.147
2	1991	416,429,500	437,349,700	(6,276,400)	30,950,700	25,599,600	23,668,300	6.147
3	1992	433,086,700	443,626,100	(5,686,100)	31,347,400	26,623,600	23,668,300	6.147
4	1993	450,410,200	449,312,200	(5,009,100)	31,696,800	27,688,500	23,668,300	6.147
5	1994	468,426,600	454,321,300	(4,237,200)	31,992,500	28,796,000	23,668,300	6.147
6	1995	487,163,600	458,558,500	(3,361,500)	32,227,000	29,947,900	23,668,300	6.147
7	1996	506,650,200	461,920,100	(2,372,400)	32,392,500	31,145,800	23,668,300	6.147
8	1997	526,916,200	464,292,500	(1,259,500)	32,480,400	32,391,600	23,668,300	6.147
9	1998	547,992,800	465,552,000	(11,500)	32,481,200	33,687,300	23,668,300	6.147
10	1999	569,912,600	465,563,500	1,383,800	32,384,600	35,034,800	23,668,300	6.147
11	2000	592,709,100	464,179,700	2,939,700	32,179,500	36,436,200	23,668,300	6.147
12	2001	616,417,400	461,240,000	4,670,300	31,853,700	37,893,600	23,668,300	6.147
13	2002	641,074,100	456,569,700	6,591,100	31,393,900	39,409,400	23,668,300	6.147
14	2003	666,717,100	449,978,600	8,718,800	30,785,600	40,985,800	23,668,300	6.147
15	2004	693,385,800	441,259,800	11,071,400	30,013,100	42,625,200	23,668,300	6.147
16	2005	721,121,200	430,188,500	13,668,400	29,059,500	44,330,200	23,668,300	6.147
17	2006	749,966,000	416,520,100	16,530,800	27,906,200	46,103,400	23,668,300	6.147
18	2007	779,964,700	399,989,300	19,681,400	26,533,100	47,947,500	23,668,300	6.147
19	2008	811,163,300	380,308,000	23,144,700	24,918,400	49,865,400	23,668,300	6.147
20	2009	843,609,800	357,163,300	26,947,300	23,038,300	51,860,100	23,668,300	6.147
21	2010	877,354,200	330,216,000	31,117,700	20,867,300	53,934,500	23,668,300	6.147
22	2011	912,448,400	299,098,300	35,686,900	18,377,500	56,091,800	23,668,300	6.147
23	2012	948,946,300	263,411,400	40,688,200	15,538,800	58,335,500	23,668,300	6.147
24	2013	986,904,100	222,723,300	46,157,500	12,318,500	60,668,900	23,668,300	6.147
25	2014	1,026,380,300	176,565,700	52,133,800	8,681,300	63,095,700	23,668,300	6.147
26	2015	1,067,435,500	124,431,900	58,658,900	4,588,800	65,619,500	23,668,300	6.147
27	2016	1,110,132,900	65,773,000	65,773,000	0	68,239,500	23,666,600	6.147
TOTALS - - - - - - - - - - - - - - -				430,562,200	686,519,500	1,158,972,300	639,041,100	

RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - TEACHERS

	YEAR	PAYROLL	UNFUNDED LIABILITY	PAYMENT AS PERCENT OF PAYROLL: PRINCIPAL	INTEREST	TOTAL ASSUMING PAYMENT AT MID-YEAR	IN 1989 $'S (4% INFLATION)	PAYMENT AS % OF PAYROLL
1	1990	407,025,000	743,227,700	(11,716,400)	52,670,500	42,489,900	40,855,700	10.439
2	1991	423,306,000	754,944,100	(10,834,100)	53,426,400	44,189,500	40,855,700	10.439
3	1992	440,238,200	765,778,200	(9,815,200)	54,111,200	45,957,100	40,855,700	10.439
4	1993	457,847,800	775,593,500	(8,646,600)	54,714,400	47,795,300	40,855,700	10.439
5	1994	476,161,700	784,240,100	(7,314,200)	55,224,700	49,707,100	40,855,700	10.439
6	1995	495,208,100	791,554,300	(5,802,600)	55,629,600	51,695,400	40,855,700	10.439
7	1996	515,016,500	797,356,900	(4,095,300)	55,915,300	53,763,200	40,855,700	10.439
8	1997	535,617,100	801,452,200	(2,174,200)	56,067,000	55,913,800	40,855,700	10.439
9	1998	557,041,800	803,626,400	(19,800)	56,068,300	58,150,300	40,855,700	10.439
10	1999	579,323,500	803,646,200	2,388,800	55,901,700	60,476,300	40,855,700	10.439
11	2000	602,496,400	801,257,400	5,074,400	55,547,700	62,895,400	40,855,700	10.439
12	2001	626,596,300	796,183,000	8,061,700	54,985,200	65,411,200	40,855,700	10.439
13	2002	651,660,100	788,121,300	11,377,400	54,191,400	68,027,700	40,855,700	10.439
14	2003	677,726,500	776,743,900	15,050,200	53,141,400	70,748,800	40,855,700	10.439
15	2004	704,835,600	761,693,700	19,111,200	51,808,100	73,578,700	40,855,700	10.439
16	2005	733,029,000	742,582,500	23,594,000	50,162,000	76,521,900	40,855,700	10.439
17	2006	762,350,200	718,988,500	28,535,100	48,171,200	79,582,700	40,855,700	10.439
18	2007	792,844,200	690,453,400	33,973,600	45,800,900	82,766,100	40,855,700	10.439
19	2008	824,558,000	656,479,800	39,951,900	43,013,600	86,076,700	40,855,700	10.439
20	2009	857,540,300	616,527,900	46,515,800	39,768,300	89,519,800	40,855,700	10.439
21	2010	891,841,900	570,012,100	53,714,700	36,020,700	93,100,600	40,855,700	10.439
22	2011	927,515,600	516,297,400	61,602,000	31,722,900	96,824,600	40,855,700	10.439
23	2012	964,616,200	454,695,400	70,235,100	26,822,800	100,697,600	40,855,700	10.439
24	2013	1,003,200,800	384,460,300	79,676,200	21,264,000	104,725,500	40,855,700	10.439
25	2014	1,043,328,900	304,784,100	89,992,300	14,985,500	108,914,500	40,855,700	10.439
26	2015	1,085,062,000	214,791,800	101,255,800	7,921,100	113,271,100	40,855,700	10.439
27	2016	1,128,464,500	113,536,000	113,536,000	0	117,793,600	40,852,800	10.439
TOTALS				743,227,700	1,185,055,800	2,000,594,200	1,103,099,700	

RHODE ISLAND EMPLOYEES' RETIREMENT SYSTEM - TEACHERS

	YEAR	PAYROLL	UNFUNDED LIABILITY	PAYMENT BY SUM OF DIGITS METHOD				
				PRINCIPAL	INTEREST	TOTAL ASSUMING PAYMENT AT MID-YEAR	IN 1989 $'S (4% INFLATION)	PAYMENT AS % OF PAYROLL
1	1990	407,025,000	743,227,700	6,367,500	51,852,800	60,403,600	58,080,300	14.840
2	1991	425,341,100	736,860,200	7,996,500	51,408,900	61,633,100	56,983,300	14.490
3	1992	444,481,500	728,863,600	9,624,100	50,851,000	62,742,800	55,778,100	14.116
4	1993	464,483,100	719,239,600	11,251,600	50,179,500	63,734,800	54,480,700	13.722
5	1994	485,384,900	707,988,000	12,879,100	49,394,500	64,608,900	53,103,800	13.311
6	1995	507,227,200	695,108,900	14,506,600	48,496,000	65,365,200	51,659,100	12.887
7	1996	530,052,400	680,602,200	16,134,200	47,483,900	66,003,700	50,157,400	12.452
8	1997	553,904,800	664,468,100	17,761,700	46,358,200	66,524,400	48,608,800	12.010
9	1998	578,830,500	646,706,400	19,389,200	45,119,000	66,927,300	47,022,300	11.563
10	1999	604,877,900	627,317,100	21,016,800	43,766,300	67,212,400	45,406,300	11.112
11	2000	632,097,400	606,300,400	22,644,300	42,300,000	67,379,700	43,768,600	10.660
12	2001	660,541,800	583,656,100	24,271,800	40,720,200	67,429,200	42,116,100	10.208
13	2002	690,266,100	559,384,300	25,899,300	39,026,800	67,360,900	40,455,200	9.759
14	2003	721,328,100	533,484,900	27,526,900	37,219,900	67,174,700	38,791,700	9.313
15	2004	753,787,900	505,958,100	29,154,400	35,299,400	66,870,800	37,131,000	8.871
16	2005	787,708,300	476,803,700	30,781,900	33,265,400	66,449,100	35,477,700	8.436
17	2006	823,155,200	446,021,800	32,409,400	31,117,800	65,909,500	33,836,200	8.007
18	2007	860,197,200	413,612,300	34,037,000	28,856,700	65,252,200	32,210,300	7.586
19	2008	898,906,100	379,575,300	35,664,500	26,482,000	64,477,000	30,603,500	7.173
20	2009	939,356,800	343,910,800	37,292,000	23,993,800	63,584,000	29,018,900	6.769
21	2010	981,627,900	306,618,800	38,919,600	21,392,000	62,573,300	27,459,200	6.374
22	2011	1,025,801,200	267,699,200	40,547,100	18,676,700	61,444,700	25,926,900	5.990
23	2012	1,071,962,200	227,152,200	42,174,600	15,847,800	60,198,300	24,424,000	5.616
24	2013	1,120,200,500	184,977,500	43,802,100	12,905,400	58,834,100	22,952,400	5.252
25	2014	1,170,609,500	141,175,400	45,429,700	9,849,400	57,352,100	21,513,700	4.899
26	2015	1,223,287,000	95,745,700	47,057,200	6,679,900	55,752,300	20,109,200	4.558
27	2016	1,278,334,900	48,688,500	48,688,500	3,396,900	54,038,600	18,741,500	4.227
TOTALS				743,227,700	911,940,200	1,717,236,700	1,045,816,400	

1-13

Early-pension plan may cost $130 million, figures show

By D. MORGAN McVICAR
Journal-Bulletin Staff Writer

Rhode Island's early-retirement program, billed as a money-saver, will begin costing more than it saves in 1997 and eventually will cost the state and participating municipalities $130 million, according to figures provided by the state's actuary consultant.

The program will save money for six years, but will cost money each year after that until 2016, according to figures provided to the state by James Laws, a senior vice president with Martin E. Segal Co. of Boston.

"Clearly in the short term it's going to save money because employers are going to have a drop in their payroll," said Laws. "But it's a fairly lucrative early-retirement incentive program for the employees. So there is a real cost there."

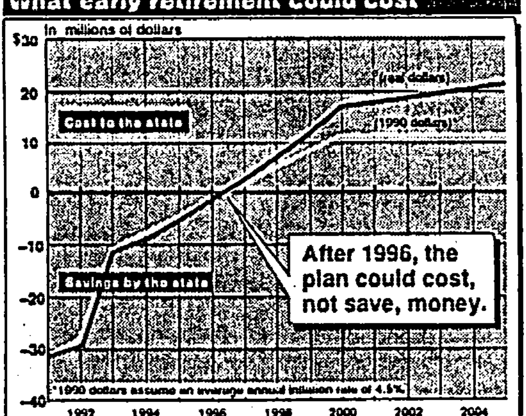
The burden will fall hardest on school departments, according to Laws' figures. An aging teacher corps is expected to take advantage of the state's offer in large numbers — and municipalities that replace teachers making maximum salaries with teachers making mimimum salaries will see an immediate saving.

But the retired teachers will draw pensions, and the new teachers eventually will earn maximum salaries. At that point, savings will cease. The state will pay part of the extra pension cost the retirements create over the long run, but school departments will pay the bulk of it.

Governor DiPrete, who proposed the program, and the General As-

Turn to COST, Page A-6

What early retirement could cost



SOURCE: Martin E. Segal Company

Cost

Continued from Page One

sembly, which passed it, did not ask for a report from the actuary consultant. But Gen. Treas. Anthony J. Solomon, who was concerned that the program would be a boondoggle, did.

The actuary firm's report arrived on Solomon's desk on June 22, less than a week before the General Assembly voted on the plan. Solomon immediately passed the report on to DiPrete.

"I am quite concerned that your current early-retirement proposal, and the early-retirement plan implemented last year, could cost taxpayers (millions of dollars)" over the next 15 years, Solomon wrote to DiPrete. "I am adamantly opposed to implementation of any plan that will have substantial long-term budgetary impact on the state."

Solomon was unaware of the $130 million figure, because the projection he received from Laws did not extend beyond 2005. But the Journal-Bulletin computed the cost of the program through 2016, the year its costs will end, based on formulas and figures Laws provided.

The $130 million is in 1990 dollars.

DiPrete, speaking through a press aide, referred questions about Segal's projections to John Kane, director of the Department of Administration. Repeated efforts to speak to DiPrete directly were unsuccessful.

Kane said the state budget office did its own study, and that it indicated that the program's costs would be far less than Segal determined.

The state's study was based on the assumption that savings over the next six years can be invested, Kane said.

Apprised of Kane's comments, Laws stood by his computations.

Laws' projections are based on several assumptions, too. He assumed that 1,700 people will take the state up on its offer to retire and that municipalities will replace retiring teachers with less experienced teachers earning half as much in salary.

He said he did not take into account the state's plan not to fill many of the positions left vacant by retirement. So the state might save more money than Laws estimated.

"The true cost is going to be based on the number that opt (for the plan)," Laws said. "We may be way off the mark in terms of the figures we used. There are so many variables."

The state Retirement Board already has explained the program's workers — and has appointments with 800 more. State workers have until July 28 to retire, and municipal employees have until Aug. 3. Laws said the savings will be greater if more people than anticipated retire — but so will the costs.

Today is the deadline for city and town councils and school committees to decide whether to allow their employees to participate in the program, which offers retirement bonuses to state and municipal employees, teachers, police officers and firefighters who are part of the state's retirement system.

However, many school and municipal officials have said they don't understand the program's implications. And despite predictions from local officials that the long-term costs will outweigh the savings, many communities have voted to participate. Some, confused about the program's impact, are planning to reconsider.

Critics of the program said Segal's estimates clarify their arguments.

"Is it sound fiscal management?" asked Dan Beardsley, executive director of the Rhode Island League of Cities and Towns. "I don't think it's fiscally sound for any school committee to stay in unless they think their community can afford to raise enough tax dollars to pay for this down the line."

He said unions have been lobbying to convince councils and committees to approve it.

Chantee Lewis, a professor of finance at Bryant College with expertise in actuarial matters, said Segal's figures suggest that the taxpayer eventually will pay for the program.

"Over the long haul it's probably not in our best interests as taxpayers," said Lewis. "I've been in Rhode Island for 16 years. I have a feeling we don't plan ahead. We do what looks good for the present. That's why it fits with Rhode Island's character that they only gave us two weeks to make up our minds."

Solomon, who said DiPrete did not consult him or the Retirement Board before making his early-retirement proposal, lashed out at both the plan and the timing.

"It's going to cost the taxpayers," Solomon said. "They're going to be socked. If we've got financial problems, we've got to address those problems. How much more can we start putting on our future generations?

"Just before the bill passed we were told about the provision that cities and towns have to refuse it. We said it's unfair to cities and towns. They don't have enough time.

"When the bills start hitting three or four years from ...

Anthony J. Solomon
General Treasurer

Jerome F. Williams
Deputy General Treasurer
For Finance

State of Rhode Island and Providence Plantations
TREASURY DEPARTMENT
OFFICE OF THE GENERAL TREASURER
PROVIDENCE

January 17, 1990

The Honorable Edward D. DiPrete
Governor
State of Rhode Island
State House
Smith Street
Providence, R. I. 02903

Dear Governor DiPrete:

In the past several months, the State has experienced substantial shortfalls in several major revenue classifications within the current 1990 budget.

While I understand that many options are being considered to address the situation, I am writing to emphasize the importance of implementing major measures now as there are less than six months remaining in this fiscal year.

My concern is twofold. First, the current economic climate in the northeast suggests that a slowdown has occurred. This is evidenced by the declining auto and retail sales and softness within the real estate market. Realistically, it would take months before signs of economic growth would surface under ideal conditions. It is therefore unlikely that trends in the revenues would change in time to raise the revenues required for this year.

My second concern is the impact on our bond rating should action not be taken by the State to recognize the full extent of the deficit and correct it. One factor that has always been noted by the rating agencies has been our ability to address any financial problems head on in a prudent fashion. This has been the one aspect which has set us apart from other States in the past. I am emphasizing again, that the time has now come to prudently address these problems prior to any impact in our rating. In doing so, we will be guaranteeing that the State will not be paying millions of dollars more in borrowing costs which directly impact future budgets.

Page 2

January 17, 1990

The Honorable Edward D. DiPrete

I would further note however, that any suggestion to erode the financial funding of the State pension system must not be considered. During the past year, a change in funding occurred which decelerated the employer contributions resulting in substantial additional cost to the State over the remaining funding period. Any further decrease in funding could cause serious damage to the plan.

I would be pleased to work with you or to provide assistance as we move forward. Decisions relating to modifications in policies should be made now in order to assure financial prudence for this budget cycle.

Sincerely,

Anthony J. Solomon
General Treasurer

AJS/cp

Chairman ROYBAL. Thank you, Mr. Solomon. The Chair will recognize Mr. Wyatt.

STATEMENT OF JOSEPH L. WYATT, JR., PUBLIC PENSION FUND ATTORNEY, HUFSTEDLER, KAUS & ETTINGER, LOS ANGELES, CALIFORNIA

Mr. WYATT. Thank you, Mr. Chairman. Good morning, Mr. Stark.

Chairman STARK. Good morning. It is nice to see you again.

Mr. WYATT. Thank you. Hello to my fellow Californians and to the others. Mr. Swett would be interested to know that in the California litigation over this very matter, New Hampshire has filed a friend of the Court brief because they consider that what is going on in California is just as important to them as it is to the rest of the country.

I am a lawyer, a partner in a Los Angeles law firm, Hufstedler, Kaus & Ettinger, and I am here because I am a trust lawyer. I have been one all my life; for about 40 years of practice. I teach about it. I write about it. I practice it right now. I represent a couple of public pension funds in California including Calpers, but I am here as an individual today.

As the other witnesses have indicated, these funds are under attack because they are successful. Trust law is about as conservative a body of law as there is. It contemplates that the trustees are supposed to act for the benefit of the beneficiaries solely and exclusively, that they are supposed to be prudent and husband the resources. To the extent that they have been successful in husbanding these resources, to that very extent those resources have become, let us say, the object of sheep's eyes from those who need money. As you know, well, better than I know, it is easier to use money that has already been collected than it is to tax somebody for money that they have in their pockets. I am not telling you anything you don't understand very well.

The point, I think, is, and I bring you this comment about the law, the law varies from State to State as to the degree of protection. In some States, the interests of pensioners vest at once upon employment. In some States, they still adhere, and so does the Federal Government I should say, under Federal law adhere to the outmoded idea that pensions are somehow gratuities, a gift from the sovereign. Got that? A gift from the sovereign. That is a little bit old sort of stuff. But that is the law in some jurisdictions which means that the pension benefits can be diminished, withheld at subsequent times as the government may wish.

Now, what, I think, is in the best of laws, the contractual rights that I think one of the members spoke of, vest immediately at the moment of employment. That is the way it is in California. There is strong law protecting pension rights and pension funds in California and many other jurisdictions. Illinois is not the only State, for example. There are about five that have some sort of constitutional provision that protects constitutionally this contractual right. There are other jurisdictions that have by decisions protected this contractual right. In California we even have imported trust law, the general duties of loyalty, prudence, care, skill, and diligence, into our constitution by a special provision.

Despite all these provisions, there is still this tendency on the part of well-meaning, well-intentioned State chief executives—and I reach across party lines that includes members of both principal parties, maybe even a third one—but I don't know about the third one, that are faced with the troublesome necessity of meeting the budget. And so they do so in the only way they know how. They look for money, as Willie Sutton said, where the money is. And the consequence of that is that the inventiveness of man mangenerically—the inventiveness of man knows no bounds. If they can't take it by just withholding the contribution, if they can't take it by misappropriating or delaying contributions, there are other ways. Actuarial assumptions, as was mentioned, is one way. In California, we are currently faced with the prospect not only of the exportation of funds but also of the changing of the governance structure of the program to remove the actuarial chore from the Board that used to control it and put it in the hands of an "independent" actuary who is appointed by the Governor, in effect, making the principal debtor of the State in charge of the person who does the figuring.

And I want to tell you right now that word actuary will crop up in your investigations as you will hear more and more. The actuary is the Uriah Heep of the pension funds. The actuary sits in the back room with gum bands on his arms and makes all the figures. You give the actuary the power, and the actuary will decide how much is going to be contributed.

So I wish to say this: as far as Federal intervention is concerned, that is pretty much up to the Congress. I won't tell you how to do your job, but if you are going to do some sort of intervening, I suggest this: I suggest intervention which makes uniform across the country the fiduciary principles which govern in the best of the jurisdictions. I suggest that that may require you also to protect the structure of governance as well as the structure of finance of these public funds.

Otherwise, you will be facing not only the concern of current retirees but, as has already been said, the interests of future retirees because we won't know what damage has really been done until people get older and start to take money out of funds that isn't there. Those are the people that you are protecting, not only the aged, but, as one of the committee's name is, the aging. And the troublesome problem is that all of us do age. And so those who are aging today will become retirees tomorrow, and if there isn't money there, that will be the danger.

The last thing I wish to say is that this fund that we are talking about collectively is one of the last big sources of capital in the country. You all are more familiar than I with the problems of the savings and loan industry, the banking industry, even the insurance industry. But this is a resource of capital which not only should be husbanded for its principal purpose, but do not forget it is a source of capital that has economic value in this country.

I will be pleased to answer any questions at some subsequent time during the hearing.

[The prepared statement of Mr. Wyatt follows:]

**STATEMENT re PUBLIC
PENSION FUNDS
by
JOSEPH L. WYATT, JR.
of Los Angeles, California
before the Meeting of the
House Select Committee on Aging and the
Subcommittee on Investment, Jobs and Prices
of the Joint Economic Committee**

Wednesday, November 20, 1991
Washington, D.C.

I am a resident of California, and a partner in the law firm of Hufstedler, Kaus & Ettinger. I am a member of the California and United States Supreme Court Bars, and a summary of my qualifications and experience in connection with Public Retirement Systems is appended as an Appendix A to this statement. Although I currently represent the largest state and largest county retirement systems in California as their fiduciary counsel, I am here today as an individual.

I. LEGAL BACKGROUND

I should first like to set the stage with a background describing the rights that most public employees have in their pension funds.

Historically, courts and legislatures viewed public employee pension benefits as gratuities, a theory which permitted legislative modification or even elimination of retirement benefits without regard to the employee's interest in them.1/

Times have changed, and many states currently considering the matter have abandoned the gratuity approach in favor of one form or another of a contract theory of public employee pension rights, either by constitution or by case law.2/ Those courts consider employee benefits a part of earned compensation, contracted for by the employee when he or she entered public employment, and which cannot thereafter be eliminated without substituting a comparable benefit.3/

The result has been that pension rights have become contractual rights, property rights, and beneficial interests in a trust fund. As such, they are entitled to constitutional protection under the state and federal Contract Clauses or the Due Process clauses of United States and state constitutions;4/ legal protection under the law of contracts;5/ and equitable protection under the law of trusts.6/

This body of legal protection has not kept state and local governments from seeking to direct the management of public retirement funds for purposes unrelated to providing payment of benefits to the participants. Sometimes the reasons for these attempted manipulations are altruistic, sometimes not. Examples include:

1. Benefits to affordable housing to employee members;7/

2. Similar benefits, but to a broader section of the local community;8/

3. Enhancement of local economic climate;9/

4. Regulation of investments to avoid distasteful foreign investments (e.g., South Africa);10/

5. Payment of the costs of legislative investigations;11/ and

6. Bail-out of financially strapped public employers.12/

These efforts have generally been approved -- when they subordinated the ultimate decisions (whether to invest the funds in accordance with legislative direction) to the discretion of the trustees in charge of the fund. In effect such laws leave it up to the trustees to decide whether to follow the legislative direction or not -- but having always in mind the interests of the fund and its participants.13/

Such legislative mandates generally failed when they did not defer to the discretion of the trustees. In such cases some governmental actions could be and have been held to violate the federal and state constitutions (contract clauses);[14] the common law of trusts;[15] and contract law.[16]

II. CURRENT SITUATION

Nevertheless, the lack of success of state and local governments in these latter cases has not halted efforts to divert public pension funds to other uses. Current newspaper accounts in current fiscal hard times herald the efforts of state chief executives and legislatures in states all over the country to emulate the Willie Sutton Syndrome -- the bank robber who robbed banks because "that's where the money is."

The most significant of these instances in terms of dollars and employees affected has occurred in California, where the Legislature and Governor have used $1.93 billion of allocated trust funds to help temporarily balance the state budget and local budgets -- a temporary remedy at best, since the ongoing recession has diminished California income prospects for the coming year as well.

This is not just a local issue. Apart from its size and importance to a large state, the Claypool case[17] has attracted the attention of administrators of fund trustees and organized public pensioners all over the country. Friend of the court (*amicus curiae*) briefs have been filed -- and accepted for filing by the appellate court considering the case -- by the following organizations:

The American Association of Retired Persons (AARP);

The National Council of Public Employee Retirement Systems (NCPERS);

The National Council on Teacher Retirement (NCTR);

The Colorado Public Employees Retirement Association;

The Los Angeles County Employees Retirement Association (LACERA) Board of Retirement;

The Louisiana State Employees' Retirement System;

The New Hampshire Retirement System;

The City of San Jose Police and Fire Department Plan;

The Texas Teachers' Retirement System; and

The Utah State Retirement Office.

The issues that the parties and amici curiae raise are numerous and important:

A. Does the use of trust funds by the employer to defray employer contributions:

1. - violate the United States Constitution Contract Clause (Article I, Section 10, clause 1), or its state analogue (e.g., Calif. Const. Art. I, §9)?

2. - violate the federal or state due process clauses -- for substantive reasons (unlawful deprivation of

property) or procedural reasons (insufficient notice and hearing to the interested participants)?

3. - violate the integrity of the trust fund under California's special constitutional provisions, which impose trustee obligations of loyalty, care, and prudence on the CalPERS Board?

4. - violate basic principles of trust law if those principles apply to public pension fund trustees?

B. Does the transfer of all control over actuarial determinations from the Board of Administration to an actuary hired by the Governor and Legislature, violate any of the foregoing principles of constitutional or trust law?

It is plain that even the resolution of all these issues in favor of the participants will not solve the problem. Far from it. So long as there is a shortage of funds in any government, those who are responsible for spending money understandably would rather spend money that has already been collected than try to collect more money with taxes or other levies on the populace. These efforts may take various forms:

1. Taking trust funds without recompense;

2. Refusing to contribute without recompense;

3. Postponing contribution for a time;

4. Diminishing contribution by adjusting the actuarial assumptions in light of the employer's needs rather than the fund's needs; and

5. Any other yet undetermined detrimental act (leaving it open to the imagination of heavily indebted state or local governments) could be enforced by either a beneficiary or a co-trustee.

To protect these trust funds from such efforts, the participants and trustees may well need all the help they can get.

III. CONGRESSIONAL INTERVENTION?

If the Congress is disposed to intervene, it can best do so by imposing, as it has done with ERISA, supervening (but not preemptive) uniform fiduciary principles upon public pension fund trustees and all those who deal with them, including the public employers and other contracting third parties.

It can do this by imposing fiduciary responsibilities on all those who control, interfere with and otherwise impede the exercise of fiduciary responsibilities by public pension fund trustees. The law of trusts comprehends such a situation, since it holds liable third parties who participate in a breach of trust. Restatement, Trusts 2d (A.L.I. 1959) §§ 185, Comment h (duty of the holder of a power to control trustee) and 326 (third persion participating in breach of trust). Any federal statute should enact a similar rule in order to render uniform this responsibility throughout the country.

With an eye to the legislative effort in California to excise the important actuarial function from further supervision by the public pension trustees, it is not enough simply to impose fiduciary responsibilities upon any such individuals or entities; they should also be required by federal law to maintain not only the integrity of the fiscal structure, but as well the governance structure responsible for the administration of the fund, to which the participants have been entitled.

However, any such legislation should not be preemptive but rather elective, complementary to any rights that public employees or trustees currently have in their local jurisdiction. It should not interfere with or preclude the exercise of local rights by the participant-beneficiaries or by the trustees seeking to protect the fund.18/

If federal law provided an additional cumulative forum rather than a preemptive forum, it would give either the beneficiary or the trustee the right to elect and would not bar them from electing the fastest and most productive remedy that they could find. That would put into statute the right of both beneficiary and trustee to oppose a third party's attempt to interfere with the exercise of fiduciary duties by the trustee.

STATEMENT OF JOSEPH L. WYATT, JR. - Endnotes.

1/ See Richardson v. Belcher, 404 U.S. 78 (1971); Fleming v. Nestor, 363 U.S. 603 (1960); Gibbs v. Minneapolis Fire Dep't Relief Ass'n, 125 Minn. 174, 145 N.W. 1075 (1914).
Bedford v. White, 106 Colo. 439, 444, 106 P.2d 469, 471 (1940) ("gratuity springing from the appreciation and graciousness of the sovereign"); accord, using similar language, Blough v. Ekstrom, 14 Ill. App.2d 153, 160, 144 NE 2d. 436, 440 (195

2/ See Recent Case Note, "Public Employee Pension Benefits," 10 Wm. Mitchell L.Rev. 287, 288 n. 5 (1984) citing cases from nine jurisdictions and four state constitutional provisions; cases collected in S.E. Achelpohl, "Public Pensions in Nebraska: Good News For The Public Employee,", 16 Creighton L.Rev. 63, 67 n. 18 (1982). The constitutional amendments appear in the constitutions of Alaska, Illinois, Louisiana, Michigan and New York; judicial decisions supporting contractual rights appear in Alabama, Arizona, Arkansas, California, Colorado, Idaho, Kansas, Montana, Georgia, and Washington. See Id. at 36, n. 39, and Annotation, "Vested Right of Pensioner to Pension," 52 A.L.R. 2d 437 (plus Later Case Service and 1990 Supplement) (abstracting cases from 39 states and federal cases).

3/ See e.g., Halpin v. Nebraska State Patrolmen's Retirement System, 211 Neb. 892, 898, 320 N.W. 2d 910, 914 (1982) ("public pensions are deferred compensation"); Betts v. Board of Administration, 21 Cal.3d 859, 863; 582 P.2d 614, 148 Cal.Rptr. 158 (1978) (pension rights are part of the earned "element of compensation" of every public employee, earned in return for his or her services).

4/ See, e.g., Betts v. Board of Administration, n. 3, supra; Halpin v. Nebraska State Patrolmen's Retirement System, n. 3, supra, and Comment, "Pensions: Public Employee Pension Plans as Contractual Obligations Granted Constitutional Protection," 20 Washburn L.J. 169, 170 (1980) and Annotation, n. 2, supra, 52 A.L.R. 2d 437 (1957).

5/ Christensen v. Minneapolis Municipal Employees' Retirement Board, 331 N.W. 2d 740, 747 (Minn. 1983) ("public employee's interest in a pension is best characterized in terms of promissory estoppel"). Cf. Crumpler v. Board of Administration, 32 Cal.App.3d 567, 582-585, 108 Cal.Rptr. 293 (1973) (equitable estoppel). See also Note, Public Employee Pensions In Times Of Fiscal Distress, 90 Harv. L.Rev. 992, 998, 1002-1003 (1977).

6/ See, e.g., Wallace v. Childers, 180 P.2d 1005, 1007 (Okla. 1947) (Firemen's Pension Fund "a trust fund in which the cities and towns have no pecuniary interest whatsoever"); Louisiana

State Employees' Retirement v. State, 423 S.O. 2d 73, 75, (La. App. 1982) ("These funds are in trust for the members of the system"); Bolen v. Board of Firemen, 308 S.W. 2d 904, 905 (Tex. Civ. App. 1957) (after the city "pays money into this trust fund, . . . the city loses control over it").

7/ Calif. Gov. Code §20215 (member home loan program).

8/ See the tabulation of locally targeted GNMA investments by 9 state administered funds in Table 6 of A.H. Munnell (et. al.), "The Pitfalls of Social Investing: The Case of Public Pensions and Housing," New Eng. Econ. Rev. 20, 27 (Sept./Oct. 1983).

9/ See, e.g., Ohio Rev. Code Ann. §145.11 (Public Employees Retirement) and 5 other statutes governing investment of state pension funds:

> "In exercising its fiduciary responsibility with respect to the investment of such funds, it shall be in the intent of the board to give consideration to investments that enhance the general welfare of the state and its citizens where such investments offer quality return and safety comparable to other investments currently available to the board."

10/ See, e.g., Calif. Gov. Code §§ 16640-16649.5 (South African divestment); Baltimore City Code Art. 22, §§ 7(a) and 35(a) (similarly), upheld in Board of Trustees [etc.] v. Mayor of Baltimore, 317 Md. 72, 562 A. 2d 720 (1989), cert. denied, ___ U.S. ___, 110 S.Ct. 1167, 107 L.Ed. 2d 1069 (1990), Annot., 103 Harv. L.Rev. 817.

11/ State Teachers' Retirement Board v. Giessel, 12 Wis. 2nd 5, 106 N.W. 2d 301 (1960) (invalidating an attempt to fund a study of the retirement system for the legislature out of earnings credited to the system's reserve).

12/ See, e.g., Valdez v. Cory, 139 Cal.App.3d 773, 785, 189 Cal.Rptr. 212 (1983) (invalidating attempt to offset employer contributions with funds from deficiency reserve); Dadisman v. Moore, 384 S.E. 2d 816 (W. Va. 1988), following Valdez, inter alia, where the Board of Trustees cooperated with the Governor in underfunding or refunding contributions.

13/ See, e.g., statutes cited at endnotes 1-3, supra; Tron v. Condello, 427 F.Supp. 1175 (S.D.N.Y. 1976).

14/ See Sgaglione v. Levitt, 37 N.Y. 2d 507, 337 N.E. 2d 592 (1975); State Teachers' Retirement Board v. Geissel, n. 11 supra.

15/ Cases cited at n. 6, supra.

16/ <u>See</u> <u>Christensen</u> and <u>Crumpler</u> cases, n. 5, <u>supra</u>.

17/ <u>Claypool, et. al. v. Wilson, et. al.</u>, 3rd Civ. C-011580, California Court of Appeal, 3rd Appellate District, briefing still in progress.

18/ Compare <u>Carpenters Southern California Administration Corp. v. El Capitan Development Co.</u>, 53 Cal.3d 1041, 811 P.2d 296, 282 Cal.Rptr. 277 (1991), cert. denied, ___ U.S. ___ (Nov. 12, 1991), holding that statute creating liens on realty in favor of welfare and pension funds is preempted by ERISA.

Chairman ROYBAL. Thank you. We will start the usual procedure. Each Member will have 5 minutes in which to ask questions, and in 5 minutes you can ask questions of the three panelists. I would like to start with Mr. Wyatt since he was the last to speak, and I would like to have further clarification of what you mean by the term "establish uniform standards of conduct for these funds."

Mr. WYATT. The fiduciary principles of common law trust were enacted into Federal law by ERISA with respect to private plans. I am not talking now about the broad provisions with respect to prohibited transactions and the like, those highly detailed and the enforcement provisions of ERISA. I am talking simply about the provisions with respect to fiduciary responsibility, that a trustee must be loyal, that a trustee must be prudent, that the trustee must exercise the prudence, care, and skill and diligence that someone familiar with such matters would do, the so-called prudent expert rule. If you were to compare a collection of common trust law that is known as the Restatement of Trusts with ERISA provisions of fiduciary responsibility, you would find that they are strikingly similar in their reading.

ERISA is simply an enactment of common law trust principles. I say to you that those principles are applied more or less in the local jurisdictions throughout this country. The problem is that there is an irregularity to the degree of their application—the extent to which trust law principles are imposed and contract law principles are imposed on the public pension fund trustees and those who deal with them. My suggestion would be that to render those uniform, these basic—what I call core—principles of trust law, that that should be the body. If there is to be Federal legislation, that that would be one area where Federal enactment would be appropriate.

Chairman ROYBAL. Thank you. Mr. Solomon, you made a reference to the same subject, but I still want to know how does one prevent a governor of any State from dipping into those funds?

Mr. SOLOMON. Well, first of all, as you know, I am here on a fact finding. As I said, I compliment you. What has happened in the past, this practice has been out of the public eye. So many governors and many legislators have done this practice in the past, and many of the media were unaware of the effects it has on the State budgets. And what you have done, you and your committee has now brought this out into the open for people to sort of look at, and I am hopeful that we by coming here to Congress and telling you not only Rhode Island's story but also along with my fellow administrators of the pension systems and their respective States, I don't have an answer. If I had an answer, I would write a book and make some real good money.

But we are here to tell you that we do have a problem. We would like to work with you. We are here to work with you, but more and more as the States are running into financial troubles, more and more State governments and local governments are now looking at pension systems as cookie jar full of goodies. In reality, it is a time bomb because the more they raid the cookie jar, that burden is now placed on our children, our grandchildren to come, and that is what we have to sort of address. And I don't really have an answer after that, and I am looking to you and to some of my fellow administrators. And maybe working together we can come up with a solution.

Chairman ROYBAL. Thank you, sir. Ms. Netsch, you stated on page five of your testimony, you said, "Underappropriated pension contributions are like unpaid credit card bills." Well, sometimes credit card bills are not paid. Does that mean that when any governor takes from the pension fund any amount of money—in your instance it was $21 million—that he doesn't have to pay it back?

Ms. NETSCH. In that case, yes. Let me say about credit cards. I suppose you are absolutely correct, Mr. Chairman, that sometimes they don't get paid at all. Sometimes there are very serious consequences if they are not paid. I think our analogy was that the underlying obligation does not disappear simply because you postpone it for a while, and I think that was the point we were making primarily.

In the case of the pension fund that the governor ordered me to transfer $21 million from, that if it happens eventually, and it is still being battled in the Courts, but if it does happen eventually, that money will not be returned to the pension fund. Now, admittedly, $21 million when you have got $10½ billion of unfunded liability is not life or death, but I think it is an extremely important principle involved. And, you know, $21 million is not inconsequential.

Chairman ROYBAL. Thank you. Mr. Stark.

Chairman STARK. Thank you, Mr. Chairman. I guess I want to direct this to Joe Wyatt and see if I understand the situation in California which I think is not completely dissimilar from other States, but seeing that that is what brought this to my attention.

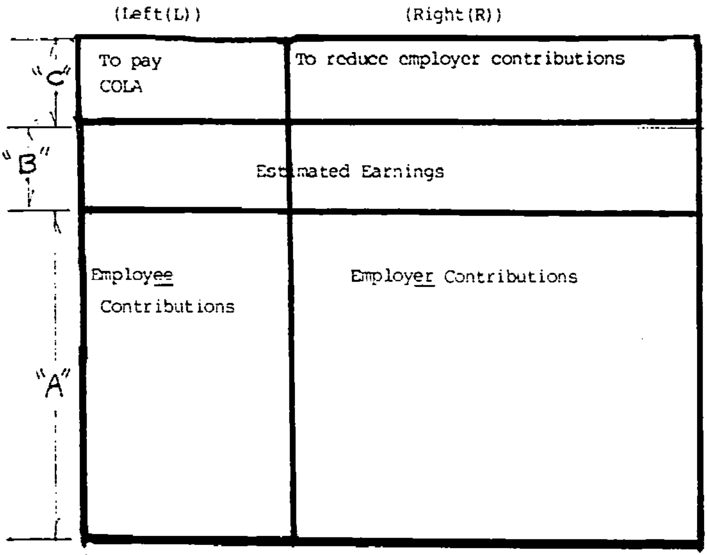
First is that we previously had an independent Board that managed the investments of the California pension funds, and these were comingled. Many different municipalities and groups had different benefits, but the money was all sort of centrally controlled by a Board, and the Board had its own actuary. And the extra earnings above some minimum base went to provide additional benefits, what we would call cost-of-living adjustments, I suppose, to these many beneficiaries. And the State was sent a bill each year for a contribution to keep this fund going at its minimum interest rate. In a year when maybe they made 12 or 15 percent, that extra was up to the Board to decide whether to give additional benefits or build a stronger base for the future. Is that roughly what used to happen?

Mr. WYATT. Yes. I wonder, Mr. Congressman, if I could draw you a picture?

Chairman STARK. All right.

Mr. WYATT. If they will bring that board over, I will draw you a picture.

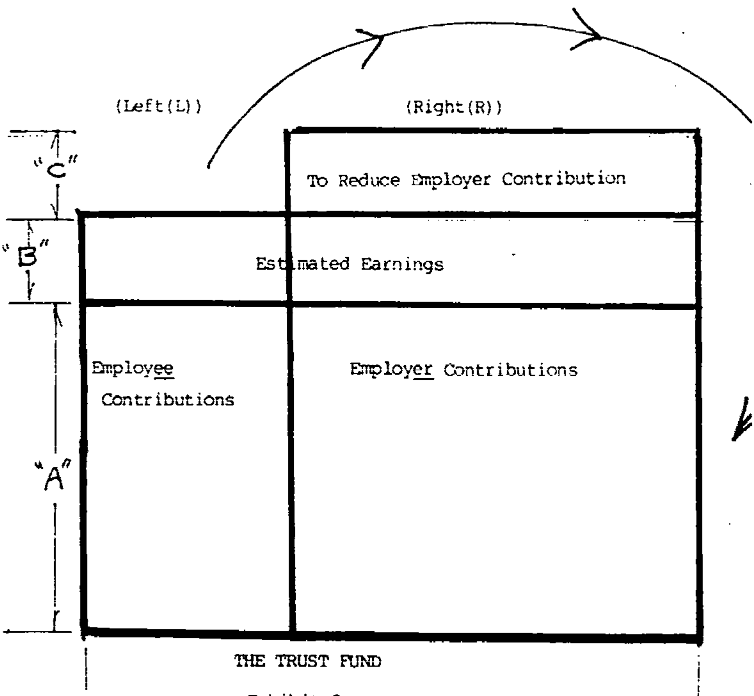
[See exhibits 1 & 2 on facing page.]



THE TRUST FUND

Exhibit 1

[Former California Law]



THE TRUST FUND

Exhibit 2

[Effect of June 30, 1991 California Legislation]

Chairman STARK. Thank you.

Mr. WYATT. Ancient California proverb: "One picture worth 10,000 words." Here is the fund. This is principal down at the bottom of exhibit 1. Employees contribute around one-third of the fund. Employers contribute about two-thirds of the fund. The actuaries, who are guessers, guess what the interest rate—in other words, what the earnings will be on this principal down here. They guess about that much. The fund made more than that for a variety of reasons. They made a lot of capital gains in the '80s for a variety of reasons unnecessary to consider here. In the middle '80s, the COLA, the cost of living adjustment, plan was proposed under which that portion of the excess beyond the expected interest rate, this top square here, would go to augment those retirees whose retirement income had dropped below 75 percent of a cost of living adjustment. That really means a highway patrolman who retired at 55 and by this time was 80, so 25 years later what he retired at is not making it.

Chairman STARK. Let me see if I understand. Let us just assume for a minute that he retired 20 years ago with a $100 a month pension, and let us assume that if you adjusted that $100 a month to today, 20 years later, to keep up with the cost of living, it should be $200—

Mr. WYATT. Right.

Chairman STARK. [continuing] but we only took him up to 150 or 175. In other words, it was an attempt to bring his earned pension in line with inflation.

Mr. WYATT. Up to 75 percent of it.

Chairman STARK. Right.

Mr. WYATT. Not 100 percent, 75 percent.

Chairman STARK. All right. Thank you.

Mr. WYATT. He had to be below 75 percent, but he got it. But where they got the money was they got the money from this corner up here, the excess earnings, not on employer contributions but on the employee contributions only. Employer contribution money has always gone down here to reduce the rate of subsequent employer contribution.

Chairman STARK. So what you are telling me is the only money that was given to the employee retiree in extra benefits was the earnings on that money that the employee had deducted from his or her paycheck?

Mr. WYATT. Correct.

Chairman STARK. Okay.

Mr. WYATT. In the fullness of time, on the 28th of June of this year, a horse-racing bill was hijacked, a term which you all may not be familiar with. I will explain it to you. It means that the horse-racing bill suddenly turned into a retirement bill. And then, lo and behold, this money disappeared. It came over here to pay off employer contributions and is currently, though under litigation, being used to eliminate employer contributions until it runs out. This money that was attributable to employer contributions, as always been the case. This legislation—the old COLA—was repealed, the money was appropriated, and is being used, to defer—not only the State's but all those local districts'—the employer contributions, and that is the subject of litigation.

Now, do not consider that our legislators and Governor were not going to do something about this. In return for taking this money, they have proposed a different COLA program which they assert will be more permanent than this program and will, therefore, last longer, be just as good. It is a promise, and I remind you of that other great California proverb that, "A bird in the hand is worth two in the bush."

Is that the explanation you wanted?

Chairman STARK. Precisely. And it seems to me that further to this a change was made in the management of these funds at two levels; one, there are certain assumptions—as you say guesses—that actuaries make that would determine the amount of the employer contribution. And that is more or less the guard on the chicken coop. If it is underfunded, future retirees will not perceive what they ought, and if it is overfunded, of course, the employer will pay too much. They removed the actuary from the Board and the independent structure and put them in the employ of the governor, the employer, as I understand the change. And now there is an attempt to remove the Board from its independent status and also bring it under the control of the employer, the State government. So that is kind of a second issue that I think we are facing.

Mr. WYATT. That is a second issue, and if you were to recall from my comments here, I said that it seems to me that if you are focusing your attention on something that is not easy to deal with, it is dealing with what I may call change of governance structure as well as financial structure, because there is case law in California that deals with efforts by the State executive to reduce contributions, direct financial raid or transfer so to speak. There is in some other jurisdictions that have dealt with this some attention to governance structure in the context of the funding mechanism, and you are right. The transfer of the actuary function is a part of this law that was enacted. The change in the structure of the Board has been abandoned "for the time being."

Chairman STARK. Good. Well, I didn't want my colleagues to think that California is the only State in the country so I yield back the balance of my time as I am sure others have their own issues, and the other witnesses who represent other States also have a problem that I am going to guess is not dissimilar although may be structurally somewhat different.

Mr. WYATT. I should only add that AARP, the National Council for Public Employees Retirement Systems, the National Council for Teachers Retirement Systems, and New Hampshire, Louisiana, Utah, and Colorado have all filed friend of the Court briefs in our California case because they do think that this matter has national importance.

Chairman STARK. Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you. Ms. DeLauro.

Ms. DELAURO. Thank you, Mr. Chairman. Mr. Wyatt, let me ask you another question, to go back to an earlier question that the Chairman asked and that is with regard to the uniform fiduciary principles. Can you give me some specifics on what you mean by developing a uniform code, if you will? And what would be involved in doing something like this? At what cost to the Federal Government, the State government, both financially and in increased paperwork, et cetera? But something about the specifics of what you are talking about in terms of a uniform code.

Mr. WYATT. Let us start out with the lowest possible cost which concerns us all. No bureaucracy at the Federal level. Item number 1, if you were to enact essentially the same fiduciary principles that are embodied in Title 1 of ERISA, namely, that any trustee has got to be loyal, got to run it for the exclusive benefit of the beneficiary, the so-called exclusive benefit or sole interest, rule.

Number 2, that the trustees have to act with the care, skill, diligence, and prudence that somebody in like capacity and with like goals would do. And mind you, a public pension trust is different from a private trust in a wide variety of respects so there is some help to having some sort of uniform language of that sort applicable to the public pension trustee as well. Although it is applicable in some States, that application is not uniform.

Number 3, a negative. Don't enact the extensive prohibited transactions legislation that is a part of ERISA and requires a substantial enforcement operation in the Department of Labor.

The only additional cost of the first things that I mentioned would be the additional costs of providing a supplemental Federal forum for complaining trustees or beneficiaries that they could resort to the Federal Courts, and that costs money as we well know. But it wouldn't cost as much as a bureaucracy in the Department of Labor or a new agency. And it would be supplemental. It would not be preemptive. I am delivering a new topic here, namely, that ERISA, under ERISA law, its remedies preempt local remedies.

What I am suggesting is that if you do choose to intervene, do not preempt the local remedies. Allow, if you please, the trustees and beneficiaries to choose whichever forum they prefer. In that circumstance, that kind of enactment would be a minimal cost. Now, it would not provide you with the opportunity short of some sort of regulatory program to find out how the systems are being run in the local areas. The reason that I omit that from my delineation is this, that most of the problems of public pension funds, public pension funds are by and large run in a goldfish bowl, are run publicly. They have to have their meetings in public. Their reporting has to be out in the open. To the extent that it is not, that may be a matter upon investigation you will find needs remedying. But most of them are publicly run, and so you can see what goes on in them. You don't have a problem, such as the Congress faced when it enacted the 1974 legislation, with people who are self-dealing, who are taking money out of the fund for their own purposes. You have got what I call other-dealing, where they are doing something with the best of intentions for the whole country or the whole State or the whole county instead of for the beneficiaries. But the result actuarially is the same.

Ms. DELAURO. Let me ask a question really of everyone and that is to explore the hypothetical: the local government is so indebted that it can't pay the pensions of former employees. What happens to the pensioners in that case? What recourse do they have? What are the likely scenarios?

Ms. NETSCH. I expect there will be a great deal of law developed on that subject in the future if we don't start turning around our pension systems. There is not a great deal at the present time. As I indicated earlier, we have what purports to be constitutional protection for at least State level employees and presumably all public employees in the Illinois constitution. And the only thing that really has been determined so far is that it does protect already vested earned benefits. They cannot be taken away. Now, if the money is not there to pay them, no one has yet addressed the question of how that particular point is going to be resolved. And we don't know that yet.

I think one of the points that is important for a number of us, we, for example, in Illinois have the prudent person rule applicable to our five State pension systems and a pretty good investment record. We have no real quarrels with that. I think the critical part of it and a much more difficult part of it for Congress to address is the underfunding. You cannot go in and mandamus a governor or a State legislature to appropriate adequate funds to cover the pension systems. And if I might put in one little plea, one reason why this is happening—it does not justify it—one reason why it is happening is because so many of the States are broke. We have not got enough money to pay the kinds of obligations that we impose on ourselves, and that in many cases you all imposed on us particularly Medicaid, of course. And that is one reason why this is happening, and I think it is something that quite seriously you are going to have to take into account as you address this question of pension funding.

Mr. SOLOMON. I believe very much that the money is not in the future. You are going to have to go back to the tax base and you are going to have to tax them. That is what is going to happen.

Ms. DELAURO. Tax them to get money that they have—

Mr. SOLOMON. Eventually the taxpayers will be paying for the future generations. Again, we are mortgaging the future generations—their future.

Mr. WYATT. The illustration of what Mr. Solomon just said is what happened in New York when New York was in bad shape, and the practical answer was they sold MAC bonds to the retirement system so the retirement system took a debt obligation back. History repeated itself this spring when Philadelphia ran into the same trouble. Philadelphia borrowed money from the funds and also from the banks, but, once again, they didn't take the money. At least they gave a paper obligation back, and the obligation was really quite financially sound. And that will have the same effect that Mr. Solomon said. It will spread. That obligation will be a general obligation, and it will be imposed upon the taxpayers to repay it.

Ms. DELAURO. Thank you.

Ms. NETSCH. If I might add just one footnote, I think one of the things that all of us have got to do, and maybe Congress can help us to do that, is to establish the fact that pensions are an integral cost of providing services. And they cannot be looked upon as a discretionary appropriation, a function of government whether it is State or local or Congress for that matter. It absolutely must be computed into the base of whatever services are being provided at the beginning.

Chairman STARK. Sort of like health care, huh?

Ms. NETSCH. Pardon?

Chairman STARK. Sort of like health care?

Ms. NETSCH. Yes.

Mr. WYATT. Why don't you raise another non-controversial subject?

Ms. DELAURO. Thank you, Mr. Chairman.

Chairman ROYBAL. Mr. Boehlert.

Mr. BOEHLERT. Mr. Wyatt, your appearance here should go into the Guiness Book of Records because I was taking notes as you were talking, and you said you won't tell us how to do our job. In the years that I have been here and the thousands of witnesses I have seen before us, you are the first one that has ever said that.

I am trying to get a good feel for the dimension of the problem. If an outside, independent objective analysis were done of the 50 States, and within the States they have many plans as I appreciate, what would that outside, independent analysis conclude in terms of the number of these plans that are underfunded? Do you have a feel, Mr. Solomon?

Mr. SOLOMON. I think you will find many of them underfunded.

Mr. BOEHLERT. Could you give me a guesstimate of a percentage?

Mr. SOLOMON. Percentage? No, I can't. But my view is my fellow State treasurers', and I am also the Chairman of Investment Commission for the Retirement System. In most of my dealings, I haven't found one that has been overfunded yet in my personal dealings with them.

Mr. BOEHLERT. All right. Comptroller?

Ms. NETSCH. This is not a total answer, but according to the Governmental Accounting Standards Board's standards for measuring pension systems, a survey was done under the so-called PBO, Pension Benefit Obligation, measure just a couple of years—well, I think within the last year. And it suggested that those that were funded—now, this, obviously, does not include all of them because we end up only with 32 at the bottom line—that those that were funded at 100 percent or more under that standard were 10 from the States responding, 90 to 99.5 percent, and on down to 60 to 64.2 percent which included, unfortunately, my State of Illinois. So a total of 32 responded to the survey, and of those, 10 met high standards of funding by this particular measure. That is not the only measure that is given. That is just one answer to your question.

Mr. BOEHLERT. So it is fair to say that the majority of these plans are at risk?

Ms. NETSCH. Yes. I don't think anyone would quarrel with that fact, sir.

Mr. BOEHLERT. All right. And then when they are at risk, there are two alternatives as we look to the future. When the time comes for the public employee to collect the benefits they have every right to expect, there either can be a diminution of benefits or an increase in the taxes to pay for the benefits. Now, are there examples of any defaults on public pension plans that you know of?

Mr. SOLOMON. No. Let me say in Rhode Island some years back we set up a 40-year plan to knock off the unfunded liability. It was a decreasing plan, so to speak. What happened, the governor came in and he came with a so-called level of funding which maybe helps out for 5 or 6 years. It reduces the State's contributions for the first 5, 6, 7 years. But after the seventh year, the State puts in more. So over the level of that 26 years, you still have an unfunded plan.

Mr. BOEHLERT. Right.

Mr. SOLOMON. To wipe it out, it is going to cost us $90 million more, but at the end of that, we are still on target on that plan. But there is an additional cost now because of the change in how we fund the plan. So many States, even though they may be underfunded, have plans in place to knock it off over the next 30 to 40 years. And I don't have the exact numbers, but there are many—

Mr. BOEHLERT. So no defaults that you know of. Are there any examples that you know of—flagrant examples—well, it doesn't necessarily have to be flagrant—of where employees had every right to expect a certain benefit, employees covered under these plans, when they retire and did not receive that benefit?

Mr. SOLOMON. I am unaware of any.

Mr. BOEHLERT. Are you?

Ms. NETSCH. No. I am not aware of any specific instance.

Mr. BOEHLERT. What I am driving at, I am trying to figure out who is at greatest risk; the public employees—

Ms. NETSCH. Or the taxpayers.

Mr. BOEHLERT. [continuing] or the taxpayers at large. And what you are telling me is that taxpayers at large better be very nervous.

Mr. SOLOMON. You hit it right on the head. It is the taxpayers because no matter what happens in the future if the money is not there, in answer to your question, the taxpayers are going to have to come in with new dollars. And I am not talking now. I am talking 20 to 30 years from now. And what I am saying, we have to start now to sort of stop this process. I am concerned about what happened in California. It is not happening in Rhode Island, thank God, but I would be concerned if the governor came in and took money out of the fund. That is trend. Believe me, that is a bad trend to start in anyone's State, and I think any other State that does it you really are playing Russian roulette.

Mr. BOEHLERT. That is just one more liability—a potentially very heavy liability that the unsuspecting taxpayer has to be concerned about. I hope the answer to this question is yes, but do you feel comfortable that the employees covered under all of these plans can look to the future knowing that they are going to get what the plan says they are going to get?

Mr. SOLOMON. Yes.

Ms. NETSCH. My guess is that those who are currently there are very likely to get whatever is written for them at the present time. I do think that there is a very real danger if we don't address this question, that employees who are hired in the future are going to be hired with a lesser benefit package; second-class employees, if you will, if we do not address the question of adequate funding because we are not going to be able to meet all those obligations. I think that is one other option, and I think that is a very real danger.

Mr. WYATT. I would add there is one example. When I, in my drawing, noted that there was going to be a substitute program for the COLA program that had been ended in California, the original program met up to 80 percent of adjusted cost of living. The substituted program goes up to only 75 percent, and I have heard from not only that highway patrolman that I talked about but a former official in a prior administration who is retired and an elderly man whose income is being reduced as a consequence. And he feels it very strongly.

Mr. BOEHLERT. Mr. Chairman, your indulgence just a little bit more if I may pursue this. With the highway patrolman, as that patrolman sat down with the family to prepare for the retirement years planning on what they are going to get from various sources to sustain an adequate standard of living, are you telling me that he got less than he had every right to expect?

Mr. WYATT. No. What I am telling you is when he retired at 60, I don't think he thought he was going to live to 85. But he knew he was going to get a certain amount of money. He got to be about 75 or 78, and it got to the pinch. And because of the pinch around the State, the COLA adjustment that I drew a picture of was enacted to meet the needs of these people. Then he planned based upon that COLA adjustment. Now, that COLA adjustment has been changed and reduced.

Mr. BOEHLERT. So the ground rules are changed in the middle of the game?

Mr. WYATT. Yes, sir.

Mr. BOEHLERT. And, boy, I think anyone has every right to be indignant, upset, and I could use stronger words, but this is a public hearing about something like that. Thank you, Mr. Chairman.

Ms. DELAURO. Would my colleague yield for 1 minute?

Mr. BOEHLERT. Sure.

Ms. DELAURO. I believe, but I don't know all the details; in answer to your question, Sherry, is that Bridgeport, Connecticut, and maybe the next set of witnesses can lend some more information, was in that situation—Bridgeport, Connecticut, as you know, declared bankruptcy. We found that the employees and the retirees were faced with a situation where the funds were not available. And as I say, I don't know all the details, but there is one example. And I am sure there are a lot of other Bridgeport, Connecticuts, in the wings, looking at potential bankruptcy.

Mr. BOEHLERT. So you say you might have had in Bridgeport a firefighter or a law enforcement official that for 25 or 30 years put their lives on the line and then retired, and no check in the mail?

Ms. DELAURO. That is right.

Chairman ROYBAL. Mr. Swett.

Mr. SWETT. Thank you very much, Mr. Chairman. I had a line of questioning that I was heading down, and then Sherry came up with, I thought, a very interesting approach which I would like to build upon. I guess what I would like to start out by saying is I enjoyed your California proverbs. It seems to me that in this instance there is a very well-known New Hampshire proverb that comes to my mind and that sounds like, "The fox is guarding the hen house," and my question is, as we talk about who is ultimately going to bear responsibility for this, the employee or the taxpayer, it seems in my mind that we haven't any mechanisms at the management level of encouraging people to keep the priorities set straight. And we discussed that a little bit. I would appreciate it if you would expand upon some of the restrictions that you feel would better take the risk off of the taxpayer and place it on the management team, the trustee, or the management personnel who are caring for these funds in order to emphasize in their work that it is, in fact, the beneficiary who should take precedence.

Mr. WYATT. You are directing that—

Mr. SWETT. I would like you to start.

Mr. WYATT. All right. A quick answer is passing over all minor problems like constitutional problems of regulating State government and interfering with State activities, what I said would apply when I talked about basic fiduciary responsibilities. It might be possible to impose those responsibilities—and this is an extension of what common law of trusts does right now in private trusts—would be to extend fiduciary responsibilities to those who either participate in what turns out to be a breach of trust by the pension trustees where there is concerted effort by an outsider and the trustees to do something as, for example, happened in West Virginia in a litigated case where the governor played some of the games we have heard about, and the trustees complied with it. West Virginia's Supreme Court said, "Hey. Let us undo that," number 1, and, number 2, "If you keep on doing it, that is a breach of trust by the trustees. It is also a breach of trust by the outsider."

The second situation is where, despite the resistance by the trustees, the outsider interferes or otherwise impedes the ability of the trustees to discharge these basic core principles that I referred to. If the same legislation imposed this common law trust principle, it would impose upon outsiders who interfere with the operation of the trust the same fiduciary responsibility. And let me tell you if you don't already know it, Mr. Swett, and I don't know your background, but the dirtiest thing you can do to somebody before you let the hammer fall on them in a courtroom is to say, "You are a fiduciary," because your obligations go right up high as soon as that happens. And if you impose fiduciary responsibilities not only on the trustees but upon those who interfere with their activities, you have, it seems to me, a strong weapon. And there is some support for that in private trust law.

Mr. SWETT. Thank you. Ms. Netsch, I am interested, and we have heard from Rosa DeLauro that there is an example of bankruptcy in Bridgeport, Connecticut, that, obviously, raises the question about how these benefits will ultimately be dealt with. And you talked about in Illinois how there are underfunding circumstances. At what point do we understand or can we identify that the problem is going to have to be dealt with? Certainly, a bankruptcy, it is obvious. But as we are having declining revenues, declining funding, how can action be taken at a particular time to ensure that bankruptcy doesn't result?

Ms. NETSCH. Well, first of all, I think one of the things that has to be understood is that many of the systems are headed for something approaching bankruptcy if there is not a turnaround. And let me just give you an illustration. My understanding is for the first time this year the State Universities Retirement System, which is one of our five State systems, actually had to dip into its investment income, its portfolio, if you will, in order to pay the benefits. That, obviously, is not going to last very long because as you reduce the amount of money that you have to invest, you are going to reduce your investment income. And since you are not getting a contribution from the employer that meets the requirements to begin with, I mean, that system is, obviously, headed for difficulty.

We have some computations that show that—this will come as a great surprise, I am sure, to Members of Congress—that the General Assembly Retirement System, which is the legislators' retirement system which is in dreadful shape in the State of Illinois, if nothing changes at the same level of employer contribution continues for the next few years, will possibly be bankrupt by the end of the decade. Now, that is just where you begin to see those things. How you get across to people to turn that around is, obviously, very, very difficult. I come back to the point that I think the things that Mr. Swett has talked about are very important for some systems. They don't make any difference in my State and possibly also in Rhode Island. Our systems are not badly managed. They just aren't funded. And that is where the trouble comes.

Obviously, Congress can help by spotlighting this, and that, I think, is precisely what your hearings are doing at the moment. I doubt very much if there is anything that constitutionally you can pass that would compel us to fund at a particular level. And that is, obviously, what we need to do. I think that perhaps by both role model and making a major issue of it you can try to help the States and local governments, by the way, to understand what Congress has to understand about its own pension systems and that is that they are not discretionary. You cannot put aside the costs of these systems and say, "We have got enough money this year. We will fund it. If we don't, we won't," because particularly with the tight financial times for the States and local governments, that temptation is going to be overwhelming. And that is part of what is happening right now.

Mr. SWETT. Thank you very much. Did you have a comment?

Mr. SOLOMON. To put your mind at ease, also Rhode Island. Before we get into trouble actually, each year the actuary has a review of the system and then makes a recommendation on the level of funding that the State and the people who belong to the system should be putting in, and that is right into the budget and submitted to the budget. So we sort of head that off before you get to that point. But the problem is increased taxes. If you don't have it, you have to increase your taxes.

Mr. SWETT. Thank you, Mr. Chairman.

Chairman ROYBAL. Thank you. The Chair recognizes Mr. Houghton.

Mr. HOUGHTON. Thank you. Do you want to continue this questioning after a while?

Chairman ROYBAL. Well, we have a vote on the floor which means that we have 15 minutes to answer that roll call. And what I had in mind is to go on for another 5 minutes and then go answer it.

Mr. HOUGHTON. Okay. Thank you. Well, I do have just a couple of brief questions. First of all, the impression I get is that States have got budget problems, States are raiding the pension funds, doing all sorts of crazy accounting maneuvers, and, therefore, you suggest we leave the plans alone. My question is as I think I brought up earlier, I am not sure what we do about this even if there is a problem. We don't really have a great deal of jurisdiction. Is it a question of violation of the IRS rules? If so, do we revoke the plans for the tax status? Wait a minute. I am not through yet. But then the State and the local governments are exempt from Federal taxes so you really tax the employer. So that is number 1.

Number 2, you know, pension planning and pension accounting is sort of a movable process. For example, in the accounting, there is a straight line versus a descending scale of bases. And I don't think—maybe you think I am wrong here—there is anything wrong if you increase gradually the amount of money put into a pension plan as long as the percent of the pay remains flat. Certainly it makes basic sense this way.

The other things in terms of assumed or actuarial rates, New York has gone from 8 to 8.75 percent, and I don't know whether you think that is right or not. I don't think there is anything wrong. It is a one-shot process. You do it and then it is finished. But long bonds are going at about 7.9 percent. The long range on the stock market appreciation is about 9.4 percent. They are about 50 percent in stocks. So, therefore, that works out to about 8¾. So I guess my point is that in making these changes there is nothing wrong in that process because private pension funds do the same thing. Would you like to comment?

Mr. WYATT. Oh, I raised my hands in horror, not mock horror, because if the pension plan were disqualified, great damage would be visited upon the pensioners who would then have all that income that they had to pay tax on because it was not a qualified plan, item number 1. That was the reason for my comment on that.

Mr. SOLOMON. Also, I may add that many States have gone from five to five and a half, to six to six and a half, to seven, seven and a half to eight, eight and a half to nine. It isn't usually a one-shot deal. Generally, as things get rougher in the State, we are seeing it more and more across the country, they start to raise this. And, sure, in good times right now we may have double digit rates of return, but if you look long term, 15, 20 years down the line, there is a possibility we may not be making double digit returns. And at that point, what do you do?

Mr. HOUGHTON. We are not talking about double digit returns. We are talking about a 50-year span on the stock market going up about 9.4 percent and also the long bonds being less than 8 percent, not too much less than 8 percent. Now, I think if you had it at 5 percent, it would be very, very, very conservative. If you had it at 12, it would be crazy. But I am just taking a look at the New York situation. Now, I don't think that is wrong, that there is something that has to move and adapt to the conditions out there particularly that is put in the light of many, many years.

Ms. NETSCH. I think most of them do make those adjustments. Most of our systems do make those adjustments. It is not an absolutely locked-in-concrete figure over a period of time.

Mr. WYATT. The question is who is going to make the adjustment, whether it will be an adjustment made—in borrowing the New Hampshire proverb about foxes, whether it is made by someone who has an interest in making the adjustment in order to lower the contribution rate or someone who has an independent interest, and that gets back to the actuary and the independence of the person who is making that judgment. The problem with increasing the rate is that as you well know the higher the return, the greater the risk. And prudence, which has already been mentioned by everyone else here, is important. And you can raise that prospect of returns so high that it becomes too risky for this sort of an investment.

Mr. HOUGHTON. That is a generalization, but it is not pointed to specific. Many industrial firms now have an assumed rate of 9 percent.

Mr. WYATT. And some pension funds do. There is wide variety, and I hold no brief for keeping it any lower than necessary. I hold a great brief for having the decision made independently.

Mr. HOUGHTON. All right. Thank you. Thank you, Mr. Chairman.

Chairman ROYBAL. Mr. Fish.

Mr. FISH. Can I just briefly? Mr. Wyatt, it should be evident to you that we all have enjoyed very much your contribution today and picking out parts of your prepared statement and asking you to embellish on it, and I will also. On page 8 where you say that, "It is not enough simply to impose fiduciary responsibilities upon any such individuals or entities; they should also be required by Federal law to maintain not only the integrity of the fiscal structures, but as well the governance structures responsible for the administration of the fund," I take it that the integrity of the fiscal structure means to be sure that present and future retirees get what they are entitled to. The governance structure responsible—is that the large net that you are throwing out to pick up more people in a fiduciary capacity? Do you want to define that term for me?

Mr. WYATT. I think the quick answer to your question is yes. The larger net plus the structure—when I include structure I include not only who runs the business whether it is being run, whether there has grown up in your particular jurisdiction, whichever it may be, a standard of performance that is essentially independent. There are jurisdictions where the principal creditor, namely, the State, is in charge of the fund. And New York is an example of that where the comptroller is a single person, and New York's law states that this is a 40-year custom. There is nothing wrong with it so long as the presiding officer, the comptroller must be held to a standard of superfairness essentially. So what I am saying is that that may be flexible, and I do not blink at the importance, and as well the difficulty, of making what I have a made in a generalized statement here. But governance includes the broad net. It also includes the people who operate the fund and the independence of them. I think that, and as I indicated in my previous answer, is what I am most interested in achieving.

Mr. FISH. Thank you. Finally—

Chairman ROYBAL. Mr. Fish, we have just 2 more minutes to answer the roll call.

Mr. FISH. Oh, we do? We better—

Chairman ROYBAL. Yes. So let us recess, and we will be back in about 10 minutes.

[Recess.]

Chairman ROYBAL. I would like to thank the first panel. The members of the second panel. Dr. Olivia Mitchell, Mr. Gerald McEntee, Mr. Richard W. Cordtz, and Mr. Arnold M. Schneider. Ms. Mitchell, will you please start the discussion? And we are going to try then to do what we did in the first panel and that is to ask you to submit your written testimony which will be included in the record followed by your summary that will take, approximately, 5 minutes. Will you please proceed, Dr. Mitchell?

STATEMENT OF OLIVIA S. MITCHELL, Ph. D., PROFESSOR OF LABOR ECONOMICS, SCHOOL OF INDUSTRIAL AND LABOR RELATIONS, CORNELL UNIVERSITY

Dr. MITCHELL. Well, good morning, and thanks very much for inviting me to this hearing. I am happy to be here and happy to have the opportunity to talk about public sector pensions and my views on some of the needs for change in public sector pension policy. My role, I think, on this committee panel is to provide counsel from the pension research academic community to try to inform your deliberations regarding public sector pension policy proposals. What I would like to do is just share briefly my own research findings on public sector funding patterns and what affects them.

Now, why do public pension plans require Federal regulation? Well, in my view, there are two major problems in the public pension arena. The first is that there is tremendous lack of data, and the second is that there are continuing pockets of problem plans, plans that are seriously underfunded. In terms of the lack of information, this is very widespread. Over the years it has been very difficult to find out even how many plans there are, what kinds of benefits they pay, what kinds of underfunding promises they have been able to put out. We need a lot more hard data on what public pensions look like.

The second concern I have is that public underfunding remains a problem in the public sector. Pension finances have been increasingly a political hot potato. It is partly because pension actuaries have to use forecasts to try to determine how much money will be put in and how much needs to be put in to meet those future promises. One of the key assumptions that has been alluded to earlier is the rate-of-return assumption because if you think the assets are going to make a high rate of return, you don't need to contribute as much. If a plan raises its rate-of-return assumption, this can dramatically reduce required contributions. One of the problems is that this rate-of-return assumption can be changed, has been changed frequently particularly lately, and is used as a source of money to cover budget shortfalls in public sector organizations.

A few recent developments have worked towards pension standardization which make the information gathering process a little bit easier. I would emphasize efforts by the Government Accounting Standards Board. This is known as GASB. They have accomplished a great deal in this regard by requiring plans to start reporting standardized liability figures as well as asset figures in terms of their current market value. A few other organizations are also trying to gather more data on what the lay of the land looks like in public sector pensions, but we still don't know a lot about the way public plans work.

Most of these plans are operating off the books from many taxpayers' and many State and local administrators' points of view. Incomplete public plan reporting and disclosure enables many politicians to make sizable pension promises to public employees while passing the cost of these promises on to future taxpayers.

Let me just take a moment to clarify what the pension promise is and why fund it. From the worker's perspective, the pension promise represents a claim to a future income stream from retirement until death in most cases. This is typically a function of when you retire, how long you have worked, and your salary. From the employer's perspective, a public sector employer or any employer who offers a future pension, that person is said to fund the plan if he or she sets aside enough money to ensure that the eventual benefits can be paid. Now, of course, as you know, in the private sector ERISA governs what private corporations can do. Lacking this legislation in the public sector, State and local employers sometimes do not reflect the full liability of these promises in their annual budgets. And this produces an environment where some, though not all, public sector employers do not contribute what they should to fund these obligations.

Now, regardless of what they actually do, I think that the economic reality is that promised benefits represent workers' and retirees' claims on future income streams which they do expect to receive. If a public sector plan is persistently underfunded, the day may come when assets fall short of benefit checks. This day, I would claim, will come due sooner than many people expect. Workers covered by public sector plans are relatively close to retirement. Almost three-quarters of all State employees with pensions are now between the ages of 40 and 45 whereas fewer than half of these folks are in that age range in the private sector. Also people retire earlier in the public sector so that this day of reckoning will come sooner. We can talk later about what might happen. It may be that State and local taxes have to be raised, and maybe the benefits have to be cut. And maybe the cost-of-living indexes will have to be readjusted.

How big a problem is public sector underfunding? With my colleague, Bob Smith, at Cornell, we have used a recent survey collected on public sector pensions covering about 4.7 million employees in 31 different States. We find first of all that the average public sector plan had assets that fell short of promised obligations by about 15 percent even after a decade of very high performing capital markets. So things are better than they were 10 years ago but by no means are they at 100 percent where they should be.

We also asked whether the pension plan sponsors contributed what the actuaries determined should be contributed to the funds. And in our data, some public sector employers did fund. However, on a flow basis, the average was only 89 percent of what they should be funding. So what we concluded was that flow funding was not what it really should have been.

Economic distress seemed to be a key reason that many public employers were underfunding. We found, for example, that if the employment growth rate declined in a State by 1 percent, this would reduce contributions by 2 percent. If the income growth rate declined by 1 percent, contributions might go down by as much as 5 percent. So that there is sensitivity to fiscal distress in the States. The good news after looking at what happened during the 80's is that public employers on average seemed to be doing relatively well. They maybe were within 15 percent of where they should have been, but the bad news is that even after the very good, very strong capital market of the last decade, they are not where they should be, and there are real threats to the system looking down the road. New and difficult challenges are being imposed by some of the things that other members of the panel have mentioned, namely, declines in State revenues and increases in expenditures.

In my view, the most important thing that your committee should be asked to consider is that public sector promises should be reported and disclosed, and funding and fiduciary standards, in my view, should be set by the Federal Government. I think that the U.S. Congress should work hand in hand with the Government Accounting Standards Board to develop sensible and systematic standards for public sector pension plan reporting and fiduciary behavior. Methods of disclosing data ought to be standardized across the States. Reporting standards ought to be standardized. In my view, it is a good idea to require public plans to file 5500 forms in exchange for tax qualification as in the private sector.

In conclusion, I thank you for your attention. I commend you for devoting your time to this important and potentially very costly problem, and I emphasize again I think that it is very important to standardize and recognize the pension promises which so far have only been partly recognized and remain underfunded. Thanks very much.

[The prepared statement of Dr. Mitchell follows:]

Public Sector Pension Policy

Prepared statement for the

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the Subcommittee on Investment, Jobs and Prices of the Joint Economic Committee
of the U.S. Congress

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by

Dr. Olivia S. Mitchell
Professor of Labor Economics
School of Industrial and Labor Relations
266 Ives - Cornell University
Ithaca, NY 14853

and

Research Associate - NBER
1050 Massachusetts Avenue
Cambridge, MA 02138

Note: Much of the analysis reported on in this presentation relies on research carried out jointly with Dr. Robert S. Smith of the Department of Labor Economics, School of Industrial and Labor Relations, Cornell University. Helpful research assistance was provided by Ping Lung Hsin and Cori Rattelman; research support from the Institute for Labor Market Policy at Cornell University is gratefully acknowledged. Dr. Mitchell remains solely responsible for this testimony; none of the institutions or other individuals named or cited is responsible for the opinions and views reported here.

Public Sector Pension Policy

Executive Summary

Many challenges face public pension plans in the 1990's with unprecedented state budget deficits and worried capital markets. If continued fiscal pressure induces public employers to reduce their annual contributions below required levels, public pension plans will run the risk of serious shortfalls. Underfunded public pensions are a major form of public borrowing against the future, yet they have received little public scrutiny until recently because data on assets and liabilities were difficult to obtain.

The analysis described here uses information from the late 1980's, and indicates some good news along with some bad news. The good news is that we find no evidence that state and local government employers persistently manipulated actuarial and economic assumptions for the purpose of reducing pension fund contributions during the 1980's. Also during that period, flow funding practices were adequate on average, though not for all plans. On the other hand, we find that public sector plans were underfunded by more than 10% on average, a finding which is troubling in light of the strong capital markets experienced during the 1980's.

In order to prevent a return to the troubled plan status of the 1970's, the Federal government should enact legislation standardizing the reporting, disclosure and fiduciary standards for public sector pension plans. Specifically, more and better data should be gathered and monitored centrally on all aspects of public sector plans. Additionally, the Federal government should scrutinize public sector pension funding and investment behavior more closely. Finally, the Congress should work together with the Government Accounting Standards Board to develop standards for public sector pension reporting and disclosure methodology. Fiduciary standards should be set and monitored, so that public sector pension promises will be taken more seriously than they have been in the past.

Testimony

Good morning and thank you for inviting me to this hearing. I am happy to have the opportunity to address this important group on the subject of public sector pension plans and needed changes in public sector pension policy.

Almost twenty years ago Congress undertook serious work on major legislation designed to project income security for retirees in by the private pension system. Though public plans were at one point to be included in that bill, they were eventually excluded from the Employee Retirement Income Security Act (ERISA) in its final form. There were several subsequent attempts to revive public pension plan regulation, culminating in recent reform efforts once again before you. It is my goal today to provide counsel from the pension research community, which can inform your deliberations regarding the problems, and offer a possible solution, to public sector pension funding problems.

Over the last two years I have been engaged in a project which explores the determinants of public employee retirement system funding. With my co-author, Professor Robert Smith at Cornell, we have developed a model of public pension funding patterns, focusing particularly on the gap between required contributions, and actual contributions -- or what we call required versus actual funding.[1] My intention this morning is to briefly describe recent pension funding patterns, and to share with your my conclusions about what affects pension underfunding.

Before going into specifics, I would like to summarize my conclusions. I submit that citizens and policymakers nationwide should be concerned about the challenges facing state and local pension funds in the United States. This is because they are under siege from all sides -- retirees wanting to protect their income streams, active workers wanting more say over fund investment policies, and politicians charged with balancing public budgets who find the pension fund an attractive source of money. If pensions are used to meet a variety of different goals in addition to guaranteeing retirement income, they may not be able to meet promises made to the millions of retirees who have served state and local governments for years. At the very least, the health of these plans may threaten the revenue-raising potential of government bodies, if the benefit claims rise to overwhelm pension assets. For these reasons, and because the public sector workforce is aging along with the rest of the workforce, funding of public sector pension plans will be even more of a challenge in decades to come.

To prevent returning to the troubled plan status of the 1970's, I believe that the Federal government should enact legislation regulating the reporting, disclosure and fiduciary standards for public plans. Specifically, more and better data should be gathered and monitored centrally on all aspects of public sector plans includging pension funding and investment behavior much more closely. Finally, public sector pension promises should be reported and disclosed, and fiduciary standards should be established by the Federal government, so that public sector promises will be taken more seriously than they have been in the past.

WHY DO PUBLIC PENSION PLANS REQUIRE FEDERAL REGULATION?

It has been argued that two of the major problems in the public pension arena "are the continuing lack of data, [and] the pockets of seriously underfunded plans".[2]

Lack of information: Over the years it has been extremely difficult to obtain information about some very basic facts about the public pension universe -- even how many plans there are, what benefits they pay, and the extent to which they advance fund benefits.

The first comprehensive study of public pension plans was a Congressionally mandated review of public plans in 1978 (CRS 1978). No similar study has been conducted since that time, though one forthcoming survey concludes that state and local pension plans cover around 10 million employees, hold assets of more than $720 billion, and pay benefits to over 3.5 million retirees and their survivors; many more expect future benefits (Phillips 1991). A Federal statistical unit should be authorized and funded to follow developments in public pensions, lest unpleasant pension surprises fall in the lap of the Federal government with no forewarning.

Pension Underfunding: Pension finances have become increasingly a front-page news item in the last three years, and frequently a political hot potato. Part of the reason for this is that pension actuaries use forecasts to determine how much future pension payouts will be, and the forecasts have implications for pension contributions needed to meet the payout obligations. In computing these forecasts, several assumptions are required, including a key one regarding the expected future rate of return on pension fund assets. If a plan raises its rate of return assumption, this can dramatically reduce the amount of money that must be contributed to the plan.

A problem that arises is that the rate of return assumption can be changed when political pressures target a public sector pension plan as a source of money to cover budget shortfalls. News reports have recently claimed that more than two-thirds of all states have adjusted their rate of return assumption so as to reduce contributions.[3] For instance, the California State Pension Fund may reduce contributions by a half-billion dollars each year, if it is permitted to adjust its rate of return assumption. The city of Philadelphia borrowed more than $130 million from its pension fund to meet payroll this spring. On the other hand there remains a question about how widespread this practice is: a recent survey concluded that about the same fraction of public and private plans changed their actuarial assumptions in 1990 -- 16% of the private plans and 13% of the public plans (Greenwich 1991). No systematic study of the entire universe of public plans has yet been undertaken however, and all reports available to date are based on small, and probably select, subsets of the pension universe.

The full extent of state and local pension financial problems is not currently known, because there exists no centralized mechanism for compiling public plan statistics and for evaluating them in a comparative fashion. In fact, there is still some question about exactly how many public plans exist, participant and retiree coverage figures are hard to come by, and assets and benefit obligation numbers are known only in the most general sense. Unlike in the private sector, public employees covered by pension plans have no standard reporting and disclosure documents that they can refer to explaining their benefit entitlements, and they tend not to know how their pension promises are funded or how pension monies are invested. In the 1990's, obtaining public sector pension information remains a frustrating and often difficult task.

A few recent developments have worked toward pension standardization, which makes the information gathering effort slightly easier. Efforts by the Government Accounting Standards Board, GASB, have accomplished a great deal in this regard, by requiring plans to report standardized liability figures, as well as asset figures valued in terms of their current market value. A few other organizations are also seeking to compile more statistics than previously available on public pension benefit promises and fund operations, but these have still not undertaken the massive task of compiling, standardizing, and making public the entire range of data needed on all public sector pension plans.

These positive developments aside, it remains strikingly clear that public sector pensions are big business, yet continue to operate almost "off the books" from many taxpayers', and state and local administrators' point of view.[4] The fundamental problem is that incomplete public plan reporting and disclosure enables state and local politicians to make sizeable pension promises to public employees, while passing the cost of these promises to future taxpayers. As Munnell (1983, p. 4) pointed out nearly a decade ago, "only federal regulation can insure that comparable and meaningful information on the nation's numerous state and local pension plans will be reported to a central agency on a regular basis". More and better data should be gathered and monitored centrally on all aspects of public sector plans. Additionally, the Federal government should scrutinize public sector pension behavior much more closely, and work to standardize repoerting and fiduciary standards across public plans in a manner accessible to taxpayers, employees and their representatives.

WHAT IS THE PENSION PROMISE AND WHY FUND IT?

THE EMPLOYEE'S PERSPECTIVE

From the employee's perspective, the pension promise represents a claim to a future income stream payable after leaving his or her employer. In the public sector, the most common type if plan is a defined benefit pension, where an employer will specify the retirement benefit formula as varying with the worker's retirement age, final average salary, and years of service. For instance, a common defined benefit annuity promise from retirement until death might equal two percent of final pay per year of service. In each year of employment, the covered worker receives wage and salary compensation in each year of active employment, and in addition accrues a claim to a pension benefit which will be paid out after retirement.

THE EMPLOYER'S PERSPECTIVE

The employer who offers a future pension is said to fund the defined benefit promise if he or she sets aside enough money to ensure that the the promised benefit stream can be paid after the worker retires. In the private sector, Congress has since 1974 required private sector plans to advance fund these promises under the Employee Retirement Income Security Act, ERISA. As I mentioned earlier, the public sector equivalent of this bill (an earlier version was dubbed PERISA) has not yet been enacted.

Lacking this legislation in the public sector, state and local employers sometimes do not reflect the full liability of promised pensions in their annual budgets. This produces an environment where some government-sector employers fully fund the benefits their workers are accumulating, but others do not. A pension plan becomes underfunded when employer contributions fall below the level required to meet accruing benefit obligations.

PAY NOW OR PAY LATER

Regardless of what public employers reflect on their balance sheet, the economic reality is that promised benefits represent workers' and retirees' claim on a future income stream which they expect to receive. If a public sector plan is persistently underfunded, the day is likely to come when plan assets fall short of benefit checks.

While this has not happened in any large plans to date, this time may arrive sooner than any of us would wish. The demographic bulge of an aging workforce, confronted with the fiscal squeeze of state budget deficits, portends a day of reckoning. This day may be hastened by the poor showing of the capital and housing market along with recent tremors in the banking and insurance industries.

If an underfunded plan runs out of money, what then? The alternatives are not appealing. State and local taxes could be raised, pay and benefits for current and prospective government retirees could be cut, or both. Alternatively, or perhaps in addition, cost-of-living indexes on benefits could be deferred (which, it must be admitted, is another way of cutting benefits). Another option, perhaps, is that angry public sector employees could descend on Washington and demand a pension insurance fund to bail out the ailing public plans, in a move reminiscent of Studebaker retirees' which got the ERISA ball rolling in the private sector almost thirty years ago.

Requiring state and local pension plans to fund more fully before the day of reckoning comes has certain virtues. First, requiring full funding requires employers offering a pension promise to recognize the eventual costs of doing so, and avoids the inherent inequity of passing along an unfunded debt to future generations. Second, requiring full funding of the pension promise would alert unionized employees to the fact that bargaining over benefits requires setting monies aside to ensure their payment. Third, requiring full pension funding will make clear to residents of each state and locality the size of the debt they are taking on, when selecting a neighborhood to live in.

These debts will come due in the very near future. Workers covered by public sector plans are relatively close to retirement. Almost three-quarters of all state employees with pensions are now between the ages of 41 and 45, whereas fewer than half of private sector covered employees are in this age range (Greenwich 1990). To complicate matters further, people retire earlier from the public sector; more than one-third of public sector employees are expected to retire before age 60, whereas in the private sector fewer than 8% will. What this means is that the demands on the public sector pension will come sooner than many realize.

How will these challenges be met? In some cases, property tax rates will certainly have to rise -- and perhaps rise a great deal. A recent study by Wilshire Associates (1990) found that six public systems were in such bad shape that assets were insufficient to meet benefit payments for current retirees: these included the West Virginia, Oklahoma, Maine and Washington DC teachers' pension plans, and the state employees' plans in Maine and Massachusetts. There will be some plans that go broke, or nearly so, even if advance funding is required for promises made as of today. However, the problem at least may be capped if sensible reporting and fiduciary standards are instituted soon.

HOW BIG A PROBLEM IS PUBLIC SECTOR PENSION UNDERFUNDING?

In the past it has been virtually impossible to determine the extent and seriousness of public sector plan underfunding. This is because, until recently, accounting practice has not required state and local governments to report a liability figure which could be compared to assets within a plan, and which further could not be readily compared across plans (Testin, and Testin and Snell, various years; Turner and Beller, 1989)

This changed in 1987 when the Government Accounting Standards Board first required public pension plans to begin reporting liability figures using a standardized actuarial computation called the "projected benefit cost method." Here pension plans are required to report pension benefit obligations using a standardized computation formula which can then be compared across plans. Similarly, plans are now required to report their assets using a standard set of definitions, so that analysts for the first time can hope to determine whether adequate provision has been made for retiree benefit payments.[5]

Using a newly compiled dataset on state and local pension fund financing practices, my colleague and I have derived several different funding measures which I will summarize for you briefly today. Taking a stock perspective first, we ask whether the pension plan's total assets equal, exceed, or fall short of the plan's total promised obligations? If the stock funding ratio is less than 1, we say the plan is underfunded in a stock funding sense.

Second we take a "flow" perspective. Here we ask: in a given year, does the pension plan sponsor contribute what is determined by actuaries to be required? If the sponsor's actual contribution amount falls short of the required amount, flow underfunding results. Naturally, if flow underfunding persists year in and year out, stock underfunding will result.

EVIDENCE

We were fortunate to have at our disposal a 1989 compilation of public sector pension financial data published by the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR). To this we added other information including measures of fiscal pressures affecting each state, indicators of each state's political environment, and a measure of alternative pay levels for public sector workers. Also we included the fraction of the active pension-covered employees who were unionized in each plan by contacting each of the pension plan sponsors in the survey. There were 42 pension plans for which complete data were available, covering 4.7 million employees in 31 states, and were of three types: teacher-only pension systems (33 percent), hybrid plans combining state, local and teachers (38 percent); and plans with only state and local workers (29 percent).

STOCK FUNDING

Our finding on stock funding patterns was that the average public sector plan in the sample had $4.9 billion in assets, and a projected pension benefit obligation of $5.9 billion. Assets were valued at market in this analysis.

If we compute the average stock funding ratio in the sample, we find that is is 84%. That is, the average plan in our data at the end of the 1980's had assets that fell short of promised benefits by 16%, even after a decade of very high-performing capital markets. [If average assets are compared to average liabilities the average stock funding ratio is 91%.]

FLOW FUNDING

Extensive analysis of flow funding practices suggest several interesting conclusions.

•<u>Some public sector employers funded their pension plans quite well. Others failed to contribute required pension obligations</u>, acting as though flow pension funding requirements were optional. This was something of a problem during the 1980's, though probably less of a problem than during the 1970's. On a flow basis, average actual contributions amounted to only 89% of required contributions annually. Also funding was poorest among plans with the most generous pension benefits.

•There was also some evidence of habit persistence: that is, public sector groups' current and past funding practices were positively correlated. <u>Plans that funded poorly in one year were also those who had a poor funding history in past years.</u>

•<u>Some public sector plans made unrealistic economic assumptions which substantially reduced the size of their projected liabilities</u>. For instance, some plans assumed a large difference between the rate of return they expected to earn on pension assets, and the assumed rate of wage growth. The greater this spread is between returns and pay growth, the less an employer will have to contribute, all else equal.

For the public sector plans in our dataset, the mean wage growth assumption was 5.6%, with an investment return assumption of 7.6%. This spread of 2% utilized during the 1980's is comfortably close to both historic and recent real interest rates in the United States. Therefore on average, <u>there was no evidence of flagrant disregard for economic and accounting norms in our data</u>.

<u>Unfortunately the assumptions used in public plans may have become less conservative since our data were collected, which would not bode well for future pensioners</u>. This is because benefit payouts depend on the pension assets being there, irrespective of political pressures that may be brought to bear on actuaries choosing investment return assumptions. Initial evidence on this point is provided in a study of public plans just released by Greenwich Associates (1991). That study reported that public plans used an investment assumption of 7.8% in 1988, rising to 8.0% in 1990, increasing the spread between investment returns and wage growth from 1.9% to 2.2%. This suggests that actuarial assumptions in state and local pension plans have changed in the 1990's so as to lower public employers' contribution levels.[6]

•<u>Economic distress seems to be a key reason that public employers tend to underfund</u>. Fiscal pressure is measured in three ways in my research: as a curtailment in income growth rates, a decline in employment growth, or an increase in unemployment rates. My results indicate that a 1-percentage point decline in a state's employment growth is linked to a 2% drop in annual per worker pension plan contributions -- holding fixed required contributions (see Table 1). A 1-percentage point drop in a state's income growth rate is associated with a 5% drop in contributions. Finally a 1-percentage point increase in a state's unemployment rate appears to be associated with a 1.6% decline in contributions.

•Other things equal, greater unionization is associated with lower levels of actual pension funding. The net negative effect is probably due to the upward pressure on salaries associated with collective bargaining, to which employers respond by lowering pension contributions.

<u>THE OUTLOOK</u>

Underfunded public pensions are a major form of public borrowing against the future, yet they receive little public scrutiny.Our analysis of recent data from the late 1980's suggests some good news and some bad news. The good news is that public employers appeared not to be persistently manipulating actuarial and economic assumptions for the purpose of reducing pension fund contributions. Also during the 1980's flow funding practices seemed adequate on average, though not complete.

However, the bad news was that public sector plan funding ratios were underfunded upwards of 10% on average, which is troubling in light of strong capital markets during the decade of the 1980's. Our results also suggest that fiscal pressures induce public sector employers to reduce their annual contributions below required levels. The current recession could therefore be expected to impose even more difficult challenges on public pension plans.

In order to prevent a return to the troubled plan status of the 1970's, policymakers should enact legislation regulating the reporting, disclosure and fiduciary standards for public plans. Specifically I submit that:

1. More and better data must be gathered on all aspects of public sector plans.
Some states have several hundred plans, others have a few; some are funded well, and some are abysmally funded. This study was able to analyze only 42 plans -- covering just under half the total number of public sector employees with pension plans. A federal statistical unit should be authorized and funded to follow developments in public pensions, lest another state-created financial problem drops in the lap of the Federal government with no forewarning.

2. Public sector pension funding and investment behavior should be scrutinized with much more care.
More and better data should be gathered and monitored centrally on all aspects of public sector plans. Additionally, the Federal government should scrutinize public sector pension funding and investment behavior much more closely.

3. Public sector pension promises should be reported and disclosed, funding and fiduciary standards should be met, and, in general, promises be taken more seriously.
The U.S. Congress should work hand in hand with the Government Accounting Standards Board to develop sensible and systematic standards for public sector pension plan reporting and fiduciary behavior. Reporting standards, methods of disclosing data regarding plan assets and liabilities, fiduciary standards, and funding methodology should be made comparable across public plans in a manner accessible to taxpayers, employees and their representative policymakers. Related to this point is the liability states and localities have accrued, but have not pre-funded, for retirees' health insurance benefits. In any consideration of recognizing public sector promises, this should rank as a high priority.

In conclusion, I thank you for your attention at this hearing, commend you for focusing on this important and potentially very costly problem, and strongly encourage you to require further standardization and recognition of promises made to public sector employees, which have only partly been recognized and pre-funded.

Table 1
Predicted Effects of Fiscal Distress on Public Sector Pension Fund Contributions

	Public pension contributions will change as follows:	
If this changes:	**Actual Contributions**	**Actual/Required Contributions**
Employment Growth Rate declines by 1 percentage point	-2.3%	-2.0%
Income Growth Rate declines by 1 percentage point	-5.4	-4.8
Unemployment Rate rises by 1 percentage point	-1.6	-1.5

Note: Estimated responses are equal to the partial derivative of actual contributions with respect to each of the explanatory variables stated, assuming that the following factors are held constant: required contributions, stock funding ratios, average pay, unionization, salary and pay growth assumptions, benefit percentages, alternative wages, and a set of political variables described in Mitchell and Smith (1991).

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ENDNOTES

[1]Much of this research is summarized in a working paper available from the authors on request; see Mitchell and Smith (1991). For a general discussion of pensions in the labor market see Gustman and Mitchell (forthcoming 1991).

[2]Munnell (1983, p. 2).

[3]See for example Durgin (1991); Employee Benefit Plan Review (1991); Hemmerick (1991); Price (1991); and Verhovek (1990).

[4]See Leonard (1986).

[5]The categories included in the pension benefit obligation (PBO) measure of liabilities are (see Allen et al, 1988; and Zorn, 1990):

(1) benefits pledged to currently retired employees,
(2) benefits to vested terminated employees, based on past service,
(3) benefits to vested active employees, based on currently accumulated service,
(4) prospective benefits payable to active employees not yet bested, and

(5) benefit increases to be earned by current workers resulting from future salary increases. In Mitchell and Smith (1991) we use the reported PBO measures, and also recompute the PBO figures using alternative salary growth rates, investment rates of return, turnover and mortality patterns, and retirement ages. Results are similar to those discussed here.

6 It should be noted that public funds still use a lower investment rate asumption than do corporate funds -- 8% versus 8.7% in private plans according to the Greenwich figures for 1990 -- but this is inderstandeable as it reflects different investment portfolios between public and private pension plans.

Chairman ROYBAL. Thank you, Dr. Mitchell. The Chair recognizes Mr. McEntee.

STATEMENT OF GERALD W. McENTEE, INTERNATIONAL PRESIDENT, AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, AFL-CIO

Mr. McENTEE. McEntee. Thank you. Thank you, Mr. Chairman. I am not an actuary, nor do I have a lot of statistics to quote from, but I am the president of a union of 1.3 million members that work in the public sector that are concerned with this problem and that feel the impact of this problem almost every day, particularly now. Our union appreciates the opportunity to share with you our views on the fiscal crisis that has gripped our cities and States and counties. The impact of this crisis on public pension funds and the need for Federal legislation to ensure that minimum reporting, disclosure, and fiduciary standards are met by State and local government retirement systems.

Mr. Chairman, State and local governments are in the worst financial condition since the Great Depression. A decade of Federal cutbacks, skyrocketing health care, and correction costs pushed budgets permanently out of balance. Now, the national recession has delivered the knockout punch. Federal aid to States and local governments has dropped dramatically over the last decade. As a result, deficits at the local level have soared. Vital services have been cut. Public employees who deliver these services have been laid off and taxes have risen. Without a doubt, this State and local fiscal crisis has had a devastating impact on public pension funds. We have seen numerous attempts, some successful, to ease budget deficits by changing actuarial assumptions, by delaying contributions and by reducing benefits and more.

I would like to discuss three cases; the States of California, New York, and West Virginia. But in retrospect as I sat here and listened to the previous testimony, I think the California case has already been discussed and delivered so I will not go into detail. But suffice to say that the governor of that State proposed actions that we believe are a blatant power grab that reaches into the pockets of every employee, retiree, and their family to yank out their retirement savings. It is inexcusable, and in the private sector such actions would not be possible.

Another example of action-threatening pension rights has occurred in New York State and is the subject of pending litigation. A lawsuit, in fact, was filed by Local 1000 of AFSCME to reverse the State's decision to change the actuarial funding method. We are opposed to the change because it would have the effect of reducing the State's current pension contributions. This suit is still in discovery. This case, also like California, represents a diversion of public funds to non-pension purposes. It will also hurt pensioners and set a bad precedent. If New York and California can get away with such power grabs, any State in the country can do it.

In West Virginia beginning with the 1985-86 Fiscal Year, the governor's annual budget request included less money for the State retirement fund than was recommended by the system's actuary and requested by its trustees. This worsened to the point that the governor's budget request for FY 88 did not include anything for the Statewide pension system, nothing at all.

A public employee retirement association, as well as AFSCME, finally sued the governor. The West Virginia Supreme Court held that the governor had the duty to include the actuarially-determined funding requirement in the budget, and the legislature had the duty to appropriate the funds. These are just a few of the many examples of the increasing attempts by State and local governments to assert control over public pension funds and to use them for purposes other than that for which they were intended.

To correct these problems, and someone said earlier that in terms of Mr. Wyatt when he testified, that he was the only one in so many recent years that didn't come up here and ask or tell the Congress what to do. We don't want to see that create a precedent so we do have some suggestions in terms of the way you can fix this problem. To correct these problems, we firmly believe that Congress must pass Federal legislation which would, number one, protect the interests of participants and beneficiaries in public employee retirement systems. Number two, require disclosure and reporting to plan participants and their beneficiaries, employers, employee organizations, and the general public of financial and other information about such plans.

Number 3, provide a Federally guaranteed program to promote and protect the investments of non-profit, institutional investors in certain economically targeted investments, such as affordable housing, protection and improvement of the environment. Number 4, expand the Pension Benefit Guarantee Corporation insurance program to include public pension plans. And, number 5, enact fiduciary and reporting standards for public pension plans similar to the requirements of private plans mandated under the Employee Retirement Income Security Act of 1974. Since the enactment of ERISA 17 years ago, such standards have been required of the private sector, but public pension plans have been left out.

Mr. Chairman, we believe that these requirements are minimum Federal protections that are needed and should be considered by Congress. The examples I have outlined illustrate the need for greater oversight and scrutiny over the deferred wages, and let me stress that, over the deferred wages of public sector employees. We think that this hearing represents a good start in this area, and we were extremely pleased to be invited to present this testimony. Thank you, Mr. Chairman. Thank you, Mr. Co-Chairman.

[The prepared statement of Mr. McEntee follows:]

AFSCME®
American Federation of State, County and Municipal Employees, AFL-CIO
1625 L Street, N.W., Washington, D.C. 20036-5687
Telephone (202) 429-1000
Telex 89-2376
Facsimile (202) 429-1293
TDD (202) 659-0446

TESTIMONY OF

GERALD W. McENTEE
INTERNATIONAL PRESIDENT

AMERICAN FEDERATION OF STATE, COUNTY AND
MUNICIPAL EMPLOYEES (AFL-CIO)

before the

HOUSE SELECT COMMITTEE ON AGING AND THE
SUBCOMMITTEE ON INVESTMENT, JOBS AND
PRICES OF THE JOINT ECONOMIC COMMITTEE

on

THE STATE AND LOCAL FISCAL CRISIS
AND
PUBLIC PENSION FUNDS

NOVEMBER 20, 1991

in the public service

Mr. Chairman and members of the committees, I am Gerald W. McEntee, International President of the 1.3 million member American Federation of State, County and Municipal Employees. Our union represents state and local government workers, university and health care workers. I appreciate the opportunity to share with you our views on the fiscal crisis that has gripped our cities, states and counties, the impact of this crisis on public pension funds, and the need for federal legislation to insure that minimum reporting, disclosure and fiduciary standards are met by state and local government retirement systems.

State and Local Fiscal Crisis

Mr. Chairman, state and local governments are in the worst financial condition since the Great Depression. A decade of federal cutbacks, skyrocketing health care and corrections costs pushed budgets permanently out of balance. Now the national recession has delivered the knock-out punch. However, this fiscal crisis was not caused by the recession alone. It has very deep roots. Few, if any, states or localities can themselves find a permanent solution. Help has to come from Washington.

A decade ago the federal government adopted a new philosophy. It would no longer help provide the public services that people need and use every day. And it would no longer invest in the infrastructure and human resources so vital to our economy. In 1980, federal funds provided 20 cents out of every dollar spent in New York City. By 1990, only 9 cents out of every dollar came from Washington. If anything, the need for public service is greater today than in 1980. People are sicker when they show up at the hospital door, children have greater needs in schools, crime is running rampant throughout our communities, bridges and streets are in disrepair, and sewage systems are strained to the limit.

To pay for the services citizens demand, states and localities have increased their share of taxes that support such services from 36% in 1981 to 42% today. In dollar terms, that means people are paying $67 billion more state and local taxes this year than they would if the federal government still paid its share. Five years ago, another set of pressures began to accelerate: health care costs began increasing astronomically. So did corrections and education costs. These pressures blew gaps in state and local budgets that could not be filled.

On top of these problems, the recession has been devastating to state and local governments. For fiscal year 1991-92, states faced a $43 billion deficit. The combined state and local deficit exceeds $50 billion. To balance their budgets states raised taxes by some $16 billion. The remaining $27 billion gap was closed by cutting spending below inflation and service needs, by laying-off and furloughing employees, or by passing costs down to local government. Less than four months into the new fiscal year, the signs of budget stress are already beginning to reappear in Maryland, Montana, New York, New Jersey, and Connecticut. There are more to come.

Impact on Pension Funds

Without a doubt the state and local fiscal crisis has had a devastating and immediate impact on public pension funds. We have seen numerous attempts, some successful, to ease budget deficits by changing actuarial assumptions, by delaying contributions, by reducing benefits and more. A New York Times front page story on July 21, 1991 reported that at least 18 states have delayed or reduced payments to their pension plans in the last two years, or are considering doing so.

I would like to discuss three situations; the States of California, New York and West Virginia to illustrate the problems which threaten our public sector retirees.

As part of California Governor Pete Wilson's budget overhaul plan this year, he proposed structural reform of the $63 billion public retirement system, CALPERS, as a way to seize control of the fund. The agreement Wilson reached with legislative leaders from both parties is part of a comprehensive plan to solve the state's $14.6 billion deficit. It contains numerous components, including new taxes to raise revenues and reform of the state retirement system.

The proposal not only restructures the 13 member independent Board of Administrators into a smaller, more political group controlled by the Governor, but also decreases benefits under the plan. The state would recapture $1.6 billion of the retirement fund's investment profits for deficit reduction. It would also change the retirement formula to reduce future cost-of-living adjustments for retirees and base their benefits on a new formula.

In my opinion Governor Wilson's actions are a blatant power grab that reaches into the pockets of every employee, retiree, and their family to yank out their retirement savings. It is inexcusable and in the private sector, such actions would not be possible.

Another example of action threatening pension rights has occurred in New York State and is the subject of pending litigation. A lawsuit, in fact, was filed by the Civil Service Employees Association Local 1000 of AFSCME to reverse the state's decision to change from the "aggregate" to the "projected unit credit" actuarial funding method. We are opposed to the accounting change because it would have the affect of reducing the state's current pension contributions. This suit is still in discovery but may be heard in a few more months. This case, also like California, represents a diversion of public funds to non-pension purposes. It will also hurt pensioners and set a bad precedent. If New York and California can get away with such power grabs any state in the country can too.

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In West Virginia, beginning with the 1985-86 fiscal year (FY 86), the governor's annual budget request included less money for the state retirement fund than was recommended by the system's actuary and requested by its trustees. This worsened to the point that the governor's budget request for FY 88 did not include anything for the statewide pension system.

At the same time that the Governor was requesting too little or no money, the legislature was directing various state agencies to withhold all or part of their pension appropriations to be used for general fund purposes. For example, during FY 88, the governor requested zero pension money. The legislature appropriated more than $7.5 million anyway, but then "transferred and expired" that appropriation in February 1988, so that it could be used for general governmental purposes.

A public employee retirement association finally sued the governor and also the state legislature. The West Virginia Supreme Court, held that the governor had the duty to include the actuarially determined funding requirement in the budget, and the legislature had the duty to appropriate the funds and not to divert them to other purposes.

These are just a few of the many examples of the increasing attempts by state and local governments to assert control over public pension funds and to use them for purposes other than that for which they were intended. Given the current fiscal crisis it comes as no surprise that state and local governments have turned to the nearly $800 billion in pension assets. This is nothing new. It has been going on for years. But, what is sometimes forgotten is that these monies represent deferred wages and future financial security of millions of public employees. And, furthermore, these monies belong to the participants, and must be used for their exclusive benefit. Within this framework, investments that contribute to the economic health and vitality of state and local governments and their citizens, and meet other policy objectives should be considered by the trustees.

In addition, we believe that pension funds should not be used to finance unproductive merger and takeover activities, or investments which result in the loss of jobs or undermine the local community. Too many times pension funds have been used for these questionable purposes and it has to stop.

<u>A Call for Federal Protection</u>

We firmly believe that Congress must pass Federal legislation which would: (1) protect the interests of participants and beneficiaries in public employee retirement systems; (2) require disclosure and reporting to plan participants and their beneficiaries, employers, employee organizations and the general public of financial and other information about such plans; (3) provide a federally guaranteed program to promote and protect the investments of non-profit, institutional investors in certain economically targeted investments, such as affordable housing, protection and improvement of the environment; (4) expand the Pension Benefit Guarantee Corporation (PBGC) insurance program to include public pension plans; and (5) enact fiduciary and reporting standards for public pension plans similar to the requirements of private plans mandated under the Employee Retirement Income Security Act of 1974 (ERISA). Further, such legislation should include a provision for joint trusteeship with equal representation for plan participants.

Mr. Chairman, these five points are consistent with the resolution adopted, October 4, 1991 by the Public Employee Department, AFL-CIO on Investment and Control of Public Pension Assets.

The federal government has a responsibility, at a minimum, for insuring that minimum reporting, disclosure and fiduciary standards are met by state and local government retirement systems. Since the enactment of ERISA 17 years ago, such standards have been required of the private sector, public pension plans have been left out. The Pension Task Force Report on Public Employee Retirement Systems issued a report in May 1978, delineating serious deficiencies in public plans -- in the areas of funding, reporting and disclosure, and fiduciary practices. While some improvements have been made at the state level, they have been piece-meal and they have not prevented the pension crisis that we are discussing at this hearing.

Some state pension plans still have large unfunded liabilities. Not all plans set employer contributions on an actuarial basis, or even conduct actuarial valuations on an annual basis. But, most troubling, nothing prevents raids on such funds to alleviate budgetary crises. In addition, current reporting and disclosure practices of state and local pension plans are totally inadequate. Many plans fail to provide the most basic information on the financial condition of the plan on a routine basis. Some participants are unable to get such information even when they request it.

Mr. Chairman, these requirements are minimum federal protections that are needed and should be considered by Congress. The examples I have outlined illustrate the need for greater oversight and scrutiny over the deferred wages of public sector employees.

The hearing you are holding today is a good beginning and on behalf of our members I thank you. But legislation is needed. We are eager to work with you and your staff to develop and enact meaningful pension protections for public workers.

Mr. Chairman, that completes my testimony. I would be happy to answer any questions you and the other members of the committee may have.

Thank you again for the opportunity to testify.

Chairman ROYBAL. Thank you. Mr. Cordtz.

STATEMENT OF RICHARD W. CORDTZ, SECRETARY-TREASURER, SERVICE EMPLOYEES INTERNATIONAL UNION, AFL-CIO, CLC

Mr. CORDTZ. Yes. Thank you, Mr. Chairman. I am Richard Cordtz, Secretary-Treasurer of the Service Employees International Union, AFL-CIO. SEIU appreciates this opportunity to testify on the control and the use of public pension funds by State and local governments. With your consent, I would like to enter our full statement in the record.

SEIU represents more than 975,000 members working for a variety of public and private employers. Our members have negotiated pension plans with their employers at all levels of government across the country. SEIU strongly supports Federal protections for all pension plans whether the plan participants are public or private employees.

The stakes in this struggle to protect retirement savings are high. The assets of the State and local government pension plans exceed $800 billion at this time. This $800 billion was accumulated by employees who deferred wages in exchange for future financial security. Our public sector members feel that their retirement savings are threatened. In at least 18 jurisdictions including New York, Illinois, California, Maine, and Texas, public employers have attempted to raid public pensions in a misguided attempt to balance their budgets.

Earlier this year in California, Governor Wilson sought to divert $1.6 billion in assets from the $63 billion Calpers' fund to ease the budget crisis. He also created a multi-tier benefit system that will leave future retirees much worse off than under the present system. Furthermore, Governor Wilson sought the power to appoint the fund's actuary in order to control contribution levels.

SEIU is fighting these attacks through litigation and a State ballot initiative that would, among other things, reverse Governor Wilson's benefit cutbacks. Unfortunately, California is not the exception to the rule. In State after State, governors have changed funding formulas to reduce their contributions as part of the budget crisis.

In Connecticut, SEIU members have filed a grievance to block a reduction in the State's pension contribution as part of a solution to the $2.8 billion deficit. The governor is reducing contributions to the pension fund by $520 million over the next 3 years. At SEIU we believe that examples such as these indicate an urgent need to extend broad Federal protections that are available in the private sector to public sector pension plans.

Specifically, certain provisions of the tax code, ERISA, and our labor laws provide uniquely powerful safeguards for pensions. These protections should be extended to the public sector. These provisions are the exclusive benefit rule, reporting requirements, and employee representation in plan governance. Each of these provisions has proven effective and workable in the private sector. They significantly reduce the risk of arbitrary or unilateral alterations in pension plans. These legal protections are discussed in detail in my written testimony.

I would like to focus my oral comments on the representation issue. Federal requirements for participant representation and plan governance must be instituted. It is crucial that plan participants be assured that their interests are represented in decisions over contributions and investments. There is no consistent form of governance of State and local plans. States have boards of trustees ranging in size from 1 to 17 members. In one case, as you heard my colleague talk about New York State, only one party will control over the fund investment, and that is the State comptroller. About one-third of the States do not include any members explicitly designated to represent participants.

We urge Congress to institute representation rights such as are accorded to the participants in private sector multiemployer pension plans to public sector workers. It is crucial that boards of trustees be composed equally of members appointed by the employer and representatives of the participants in the pension plan. The pressure on public funds is likely to intensify in coming years, and unless we repair the fiscal foundations of Federal-State relations, governments will continue to be forced into making impossible choices among cutting essential services, raising taxes in a recession, or reneging on a pension promise to their employees. The Federal Government must fully shoulder its responsibility for national priorities like health care reform and rebuilding the infrastructure.

In closing, I would like to comment and commend these committees for continuing to examine the problems affecting the State and local pension funds. Please, please support an extension of rights long held by the private sector to the participants in the public sector pension plans. Thank you.

[The prepared statement of Mr. Cordtz follows:]

Testimony of

Richard W. Cordtz
Secretary-Treasurer
Service Employees International Union
AFL-CIO, CLC

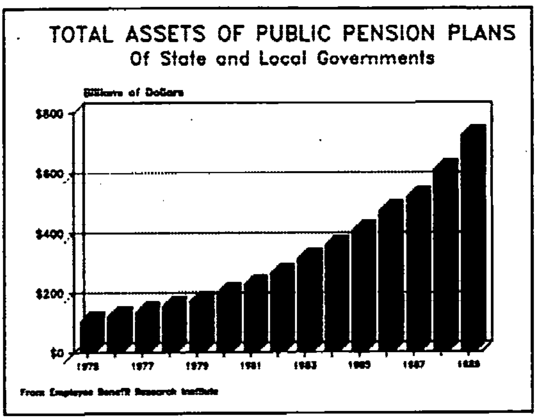
The Control and Use of Public Pension Funds by State and Local Governments

to the
House Select Committee on Aging and the
Subcommittee on Investment, Jobs & Prices of the
Joint Economic Committee
November 20, 1991

Representative Roybal, Representative Stark, members of the Committees. I am Richard W. Cordtz, Secretary-Treasurer of the Service Employees International Union, AFL CIO. The Service Employees International Union appreciates this opportunity to testify on the control and use of public pension funds by state and local governments.

The Service Employees International Union represents more than 975,000 members working for a variety of public and private employers. SEIU members have negotiated pension and other deferred compensation plans with their public sector employers at all levels of government across the country. SEIU strongly supports federal protections for all pension plans whether the plan participants are public or private employees.

The stakes in this struggle to protect retirement savings are high. Pubic pension funds have grown eight fold since 1975 and are a tempting source of funds for state and local governments. The assets of state and local government pension plans exceed $800 billion at this time. This $800 billion was accumulated by employees who deferred wages in exchange for future financial security.



Our public sector members feel that their retirement savings are threatened. Their pension assets have been put on the table in recession driven budget negotiations. In at least 18 jurisdictions, including New York, Illinois, California, Maine, and Texas, public employers have attempted to adjust contributions, change governance, or divert assets of pension plans.

Earlier this year in California, Governor Wilson sought $1.6 billion in assets from the $63 billion in the CalPERS fund to ease the budget crisis. He also created a multi-tier benefit system that will leave future retirees much worse off than under the present system. Under Governor Wilson's plan, two accounts that accrue "surplus" investment earnings to provide low income retirees with cost of living adjustments would be eliminated. Furthermore, Governor Wilson sought the power to appoint the fund's actuary in order to control contribution levels.

SEIU is fighting these attacks through litigation, and a state ballot initiative that would constitutionalize the governance structure of CALPERS in addition to reversing Governor Wilson's benefit cutbacks.

In Connecticut, SEIU members have filed a grievance to block a reduction in the state's pension contribution as part of a solution to the $2.8 billion deficit. The Governor is reducing contributions to the pension fund by $520 million over the next three years by withholding $210 million this year, followed by $160 million next year and $150 million the year after. The liability for the omitted contributions will be amortized over a 40 year period.

In Texas, the state comptroller proposed a major restructuring of that state's public pension funds, including repeal of the current law stipulating the range of permissible state pension contributions. Although only portions of that proposal were adopted, the legislature did establish a new investment committee composed of top level elected officials to assume the actuarial functions and generally oversee funding issues now handled by individual state pension fund boards.

At SEIU, we believe that examples such as these indicate an urgent need to extend protections available in the private sector to public sector pension plans. Private sector pension plans have long been carefully protected by federal laws and regulation including the Internal Revenue Code (IRC), the Employee Retirement Income Security Act (ERISA), and the National Labor Relations Act (NLRA). These statutes ensure that the employees whose labor builds the pension fund and are entitled to benefits under it actually receive the benefits; that it is a trust fund, and that, if necessary, participants and beneficiaries can go into court and obtain the benefits to which they are entitled. The federal protections for private sector plans are long-standing, clear, and workable.

I urge Congress to extend similar protections to the participants in public sector pension plans. In each of the examples mentioned before, decisions were made that deeply affected the plan's participants and beneficiaries. Yet, each time the government pension plan was put in play, the plan's participants were at risk because they lack several of the most basic protections available to private sector employees.

While SEIU supports broad federal protections for participants in public sector pension plans, certain provisions of the IRC, ERISA, and the NLRA are uniquely powerful safeguards. These provisions are the exclusive benefit rule, reporting and disclosure requirements, and requirements for representation in plan governance. Each of these provisions has proven effective and workable in the private sector. They significantly reduce the risk of arbitrary or unilateral alterations in pension plans.

First, we need ensure that pension assets are used for the exclusive benefit of plan participants and beneficiaries. The exclusive benefit rule is a longstanding concept in equity and common law. Under the rule, a trustee bears an unwavering duty of complete loyalty to the beneficiary of the trust, to the exclusion of the interests of all other parties. The exclusive benefit rule grants significant discretion to trustees in the manner of discharging the "unwavering duty".

The exclusive benefit rule underpins the federal laws that protect private sector pension plans. For example, the Internal Revenue Code states that a qualified pension plan must make impossible "for any part of the corpus or income to be . . . used for, or diverted to , purposes other than for the exclusive benefit of his employees or their beneficiaries . . .". 26 U. S. C. Sec. 401(a)(2). The Employee Retirement Income Security Act of 1976 (ERISA) states that a trustee must "discharge his duties ... solely in the interest of the participants and beneficiaries . . .". 29 U. S. C. Sec. 1104(a)(1). The National Labor Relations Act states that the assets of union welfare funds be administered "for the sole and exclusive benefit of the employees . . . and their families and dependents . . ." 29 U. S. C. Sec. 186(c)(5).

Yet, these three federal laws do not effectively extend the benefits of the exclusive benefit rule to participants in state and local government pension plans. The Internal Revenue Code applies to government plans, but the only remedy for violation is revocation of the plan's tax exemption. As a result, the only IRC penalty for a public plan that violated the exclusive benefit rule would be to tax the employees covered by the plan on their pension benefits. Such a penalty is little help to a public sector employee.

Both ERISA and NLRA have categorical exclusions for state and local governments. Therefore, state and local government employees can not turn to protections available to private sector employees under either statute. We need to act to extend coverage of the exclusive benefit rule in these statutes to public sector employees.

The Public Employee Division of the AFL CIO recently passed a resolution in support of the exclusive benefit rule.

> RESOLVED: That the AFL CIO reaffirms its position that the assets of public pension funds represent the deferred wages and future economic security of plan participants, belong to the participants, and must be used for the exclusive benefit of participants. Within this framework, plan investments that contribute to the economic health and vitality of state and local governments and their citizens, and meet other policy objectives, should be considered by trustees.

Extension of the rule to government plans would clarify the responsibility assumed by a pension plan fiduciary. Trustees and other fiduciaries have a responsibility to act to protect their pension plan from unilateral or arbitrary actions by the employer. A fiduciary of a state or local government plan could take economic conditions into account together with all the other facts and circumstances in establishing the terms, including the interest rate, for contributions to the pension plan. The fiduciary would not be able to claim "that, although he had conflicting interests, he served his masters equally well or that his primary loyalty was not weakened by the pull of the secondary." *Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 269. In addition, federalization of the rule would set uniform national standards under a widely applied statute. While many states have some common law protections for trusts, their standards for application vary widely.

Second, federal protections need to set out reporting and disclosure requirements for state and local government pension plans. Under ERISA, private sector plan administrators are required to furnish summary plan description and certain financial statements to participants and beneficiaries. 29 U.S.C. Sec. 1021(a) In addition, plan administrators are required to file plan descriptions, modifications and changes, and annual reports with the U.S. Secretary of Labor.

ERISA benefits for reporting and disclosure should be extended to government plans. If extended, our members would receive information about their plan benefits, conditions for receiving the benefits, assets and liabilities, and the administrator of the plan. This crucial information would assist our members in planning their retirement, and clearing up difficulties with their pension as necessary.

Third, federal requirements for participant representation in plan governance must be instituted. There is no consistent form of governance of state and local plans. States have boards of trustees ranging in sized from 1 to 17 members. (see *Public Pension Plans: the Issues Raised over Control of Plan Assets*, Congressional Research Service Serial No. 101 P, May 1990) The boards include elected, appointed, and ex officio members. In some cases, requirements exist guaranteeing representation by plan participants. Yet, in one case, New York State, the only party with control over fund investment is the State Comptroller. The majority of States include representatives of plan participants, but about one third do not include any members explicitly designated to represent participants.

Trustees generally hold two key responsibilities: supervision of compliance with the terms of the pension agreement between the sponsoring public employer and the employees, and broad power over investment policy. As was mentioned earlier, public employers are exerting wide spread pressure to cutback on contributions to pension plans. In California, Connecticut, Texas, the employers all attempted to severely restrict their contributions to their retirement systems. In California and Texas, the public employer seize control of the contribution level by replacing the actuary who determines necessary contributions, or changing the contribution formula.

Nationally, this pressure on contributions has resulted in massive underfunding of public pension plans. Out of every four dollars of pension liability incurred by today's public employers, one dollar is left as a bill to future generations for unfunded pension liabilities. A recent survey showed that public pension plans, overall, have assets sufficient to cover about 75 percent of their liabilities. *Public Pension Funds' Investment Practices.* National Conference of State Legislatures. February 1990. Investment policy has also been similarly flawed. Public pension assets were a key source of funding for the explosive growth of leveraged buyouts during the 1980's.

It is crucial that plan participants be assured that their interests are represented in decisions over contributions and investments. We urge Congress to institute representation rights such are accorded to participants in private sector multi employer pension plans to public sector workers. It is crucial that boards of trustees be composed equally of members appointed by the employer, and representatives of the participants in the pension plan.

The pressure on public funds is likely to intensify in coming years. Unless we repair the fiscal foundations of federal-state relations, governments will continue to be forced into making impossible choices among cutting essential services, raising taxes in a recession, or reneging on a pension promise to their employees. We must reverse this decline in federal aid to states and localities. The federal government must fully shoulder its responsibilities for national priorities like health care reform and rebuilding the infrastructure.

In closing, I would like to commend these Committees for continuing to examine the problems affecting state and local pension funds. Congress has examined these problems before without acting. Since government plans were excluded from ERISA in 1974, legislation was introduced in several sessions of Congress. These bills did not pass despite continuing evidence of danger to the participants in state and local pension plans. Let us work toward crafting a solution to the budget problems of the nineties that does not endanger our public servants retirement savings. Please support an extension of rights long held by the private sector to participants in public sector pension plans.

Chairman ROYBAL. Thank you. The Chair recognizes Mr. Schneider.

STATEMENT OF ARNOLD M. SCHNEIDER, EXECUTIVE DIRECTOR, AMERICAN ASSOCIATION OF CLASSIFIED SCHOOL EMPLOYEES

Mr. SCHNEIDER. Thank you. Mr. Chairman, my name is Arnie Schneider, and I am the Executive Director of the American Association of Classified School Employees. In behalf of the one-quarter of a million people we represent, I appreciate the opportunity to testify before your committees today on the abuse of retirement savings trust funds of public employees.

Classified school employees are the backbone of our public school system, and without them no school could function. Our members include custodians, school food workers, bus drivers, maintenance and security personnel, secretaries, clerical workers, teacher aides, library technicians, and the others who ensure that the essential services that keep our schools running are performed each and every day.

Although the services performed by classified school employees are necessary for schools to function, many of these workers are amongst the lowest paid public employees in our country. Because retirement benefits are based upon pay during active employment, our pension checks are among the lowest of retired public workers. Nationwide, the average pension for retired public sector workers is, approximately, $7,400. But for retired school employees it is much less.

In the South, our affiliate, the Alabama Association of Classified School Employees, reports that retired school bus drivers and food service workers get less than $6,000 per year after 30 years of service. In the West, our affiliate, the Oregon School Employees Association, reports that retired bus drivers and food service workers receive annual pensions of, approximately, $5,600 after 30 years of service.

If low income retirees and pensioners lose their pensions, they can not easily go back to work. That is why we are so threatened by politicians who are stealing money from our pension plans or shortchanging them to such an extent that there may not be enough money in them for tomorrow's retirees.

Mr. Chairman, there may be witnesses who will come before this committee and say, "Why worry? These public pension funds are rolling in money. There is $720 billion in some 2,400 public employee pension funds. What is the problem?" Well, the answer is that a failure to properly fund these retirement savings plans by employers now or their raiding of these funds will result tomorrow in situations that our people in Oklahoma are currently facing today.

We represent the Education Support Personnel of Oklahoma. They are participants in the Oklahoma Teachers' Retirement System. The Oklahoma system, with $2 billion in assets, needs another $3 billion to properly fund their plan today. Right now, this underfunding is resulting in a negative cash flow, meaning retirement benefits are being paid out at a rate faster than contributions and earnings are being paid into the system. By the year 2015, assets will be exhausted. The plan will be insolvent. It will be on a pay-as-you-go basis requiring $800 million a year in cash from taxpayers to pay retirement benefits for some 43,000 retired workers. We are witnessing the disintegration of retirement savings trust funds through diversion and expropriation.

It is not the same as the savings and loan crisis. It is worse. For the most part, personal savings lost in the collapse of thrift institutions were replaced by Federal insurance programs. There is no such program to make whole the retirement savings of public employees. They are not covered by the Pension Benefit Guaranty Corporation.

There are three primary issues. First, public employers are not meeting their obligations to properly fund their workers' pension plans. Oklahoma provides a prime example of this. Secondly, they are using these retirement savings trust funds as slush funds to finance public debt and government operations. Governor Pete Wilson's raid of the California Public Employment Retirement System is but one example of this. Governor Mario Cuomo has proposed using public employee pension funds to finance public works. In West Virginia, almost $100 million was diverted to maintain highways. Elsewhere, public officials are encouraging and threatening to legally mandate retirement savings to underwrite local businesses, from failing savings and loans in Kansas to a car dealership for a Rockefeller in Arkansas, even a sorority house expansion. And, thirdly, there is certainly the potential for great abuse by the trustees.

Across this land there are State constitutional and statutory protections for public employee plan beneficiaries. But the very public officials who have taken oaths to uphold the constitutions and statutes are violating them. Are there Federal protections? No. Public workers are not covered by the Employee Retirement Income Security Act, ERISA. The American Association of Classified School Employees urges that Congress consider adopting ERISA-like protections for 12 million active public employees and 4 million retirees currently.

Mr. Chairman, the balance of my testimony contains examples of the issues and problems I have raised. I ask that my entire testimony along with exhibits be made part of the record of this hearing, and thank you very much for the opportunity to be here.

[The prepared statement of Mr. Schneider follows:]

Statement
of
Arnold M. Schneider
Executive Director
of the
American Association of Classified School Employees

Before the
House Select Committee on Aging
and the
Joint Economic Subcommittee on Investment, Jobs and Prices

November 20, 1991

Mr. Chairman, my name is Arnold M. Schneider, and I am Executive Director of the American Association of Classified School Employees (AACSE). In behalf of the quarter of a million people we represent, I appreciate the opportunity to testify before your Committees today on the abuse of retirement savings trust funds of public employees.

Classified school employees are the backbone of our public school system, and without them, no school could function. Our members include custodians, school food workers, bus drivers, maintenance and security personnel, secretaries, clerical workers, teacher aides, library technicians and others who ensure that the essential services that keep our schools running are performed each day.

Although the services performed by classified school employees are necessary for schools to function, many of these workers are among the lowest paid public employees. Because retirement benefits are based upon pay during active employment, our pension checks are among the lowest of retired public workers. Nationwide, the average pension for retired public sector workers is $7,400. But for retired school employees it is much less:

- In the South, our affiliate, the Alabama Association of Classified School Employees, reports that retired bus drivers and food service workers get less than $6,000 a year after 30 years of work.

- In the West, our affiliate, the Oregon School Employees Association, reports that retired bus drivers and food service workers receive annual pensions of about $5,600 after 30 years of work.

If low income retirees lose their pensions, they cannot easily go back to work. That is why we are so threatened by politicians who are stealing money from our pension plans or shortchanging them to such an extent that there may not be enough money in them for tomorrow's retirees.

Mr. Chairman, there may be witnesses who will come before you and say, "Why the worry? These public employee pension funds are rolling in money. There is $720 billion in some 2,400 public employee pension plans."

The answer is that a failure to properly fund these retirement savings plans by employers or their raiding of these funds will result tomorrow in situations nationwide that our members in Oklahoma face today.

We represent the members of the Education Support Personnel of Oklahoma who are participants in the Oklahoma Teachers' Retirement System.

The Oklahoma system, with $2 billion in assets, needs another $3 billion to be properly funded, today. Right now, this underfunding is resulting in a negative cash flow -- meaning retirement benefits are being paid out at a rate faster than contributions and earnings are being paid into the system. By the year 2015, assets will be exhausted. The plan will be insolvent. It will be on a pay-as-you-go basis, requiring $800 million a year in cash from taxpayers to pay retirement benefits to 43,000 retired workers.

We are witnessing the disintegration of retirement savings trust funds through diversion and expropriation.

It is not the same as the savings and loan crisis -- it is worse. For the most part, personal savings lost in the collapse of thrift institutions were replaced by a Federal insurance program. There is no such program to make whole the retirement savings of public employees. They are not covered by the Pension Benefit Guaranty Corporation.

There are three primary issues:

1. Public employers are not meeting their obligations to properly fund their workers' pension plans. Oklahoma provides an example of this.

2. They are using these retirement savings trust funds as slush funds to finance public debt and government operations. Governor Pete Wilson's raid of the California Public Employees' Retirement System is but one example of this.

   Governor Mario Cuomo has proposed using public employee pension funds to finance public works projects. In West Virgina, almost $100 million was diverted to maintain highways.

   Elsewhere, public officials are encourging and threatening to legally mandate retirement savings to underwrite local businesses -- from failing savings and loans in Kansas to a car dealership for a Rockefeller in Arkansas -- even a sorority house expansion.

3. There is potential abuse by Trustees.

Across this land, there are State constitutional and statutory protections for public employee plan beneficiaries. But the very public officials who have taken oaths to uphold their constitutions and statutes are violating them.

Are there Federal protections? No. Public workers are not covered by the Employee Retirement Income Security Act -- ERISA. The American Association of Classified School Employees urges that Congress consider adopting ERISA-like protections for 12 million active public employees and 4 million retirees.

It was similar abuses in the private sector that resulted in the enactment of ERISA in 1974. If public employers were subject to the same standards as their private sector counterparts under ERISA, some elected officials today would be in jail.

OREGON

Mr. Chairman, I noted that one area of concern is potential abuse by trustees. An example can be found in the Oregon Public Employees Retirement System which became the shill for the leveraged buyout crap games run by Kohlberg, Kravis, Roberts (KKR) in the 1980's.

KKR developed schemes in which front money was put together to buy companies -- with the bulk of the financing for the deals coming from junk bonds. For the leveraged buyout of RJR Nabisco, KKR's seed money came from the State pension plans of Oregon, Washington, New York, Wisconsin, Illinois, Iowa, Massachusetts, Montana, Michigan and Utah. Some 55 percent of $5.6 billion raised to do the RJR Nabisco deal came from these State trust funds.

I offer for the record of this hearing an article that appeared in The New York Times Magazine of May 5, 1991 (Exhibit 1) by Sarah Bartlett. It is entitled "Gambling with the Big Boys" and it is taken from Ms. Bartlett's book entitled The Money Machine. Ms. Bartlett details the following:

- KKR made political contributions to some elected officials who sat on the boards of these State plans and made decisions to contribute hundreds of millions of dollars from worker retirement trust funds to KKR.

- An Oregon pension fund fiduciary who fronted for KKR and encouraged other State plans to invest asked KKR to allow him to make personal investments in their deals. KKR refused until he left the State's service.

These may not be examples of illegal conduct. However, rewarding fiduciaries for their investment decisions and contributions by investment advisors to politicians on trust fund boards are, at least, sleazy.

But what is especially troubling is the use of worker retirement trust funds in investments that tore apart corporations and resulted in thousands of other workers losing their jobs. Furthermore, LBOs were speculative investments. Why were trust funds making such investments? There is at least one reason.

Public employee pension fiduciaries are frequently elected officials. They had political reasons for investing in LBOs. These investments were risky but they offered the prospect of greater returns. The greater the investment income the less the public employer is required to contribute to the pension plans. That can mean less reliance on tax receipts to fund the pension obligations.

Politicians and pension plan staffs in Oregon, Washington and other States used the rewards from high risk investments to offset employer payments to the retirement trust funds. They bet the farm, you might say.

OKLAHOMA

Other public employers are not meeting their obligations to properly fund their public employee pension plans. One of the States with which we are concerned is Oklahoma, where our affiliate is known as Educational Support Personnel of Oklahoma. These workers and retirees are beneficiaries of the Teachers' Retirement System of Oklahoma, which reported in its February, 1991 newsletter for members that:

> *...[There will be] a steady decline in the financial condition of the Teachers' Retirement System, unless significant changes are made in the level of funding provided to the system.*
>
> *...Not only will the number of active and retired members increase, but the annual benefit payments paid to retired TRS members will grow from less than $300 million today to more than $1.1 billion by the year 2013. The assets of Teachers' Retirement will continue to increase for approximately the next 15 years, then they will decline sharply as increased benefit payments require the use of a larger portion of assets to meet annual obligations.*
>
> *By the year 2015, assets will be exhausted, total liabilities will be over $12 billion, and the System's only source of income will be member and employer contributions. At that point the System will be on a 'pay-as-you-go' basis and the State will have to provide $800 million a year to pay benefits to approximately 43,000 retirees.*

While officials of the Oklahoma plan and the legislature are not sitting idly by watching the situation deteriorate, they are, nevertheless, confronted with a difficult problem. The specific concern of the American Association of Classified

School Employees is that the current active members of our affiliate, Educational Support Personnel of Oklahoma, may face their retirement years with a bankrupt pension fund. There is $2 billion in the fund and it needs $3 billion more, today, to be adequately funded. Mr. Chairman, I offer for the record of this hearing the February, 1991 issue of Trends (Exhibit 2), a publication of the Teachers' Retirement System of Oklahoma which contains a report of this situation.

OTHER STATES

There are other examples. Among them is Maine. Earlier this year, the Maine Governor signed into law a measure that defers $13.5 million in contributions to a teacher retirement fund until the beginning of the next fiscal year. However, the legislation does not specifically require payment of the deferred funds next year, and the $13.5 million may become part of the plan's unfunded liability. The Governor's budget for the next two fiscal years calls for a savings of $60 million annually by not paying the unfunded liability of the pension plans covering both teachers and State employees.

And in Alabama, members of our affiliated Alabama Association of Classified School Employees joined in a protest that stalled a plan this year by the State Legislature to reduce the State's $150 million budget shortfall by scaling back contributions to the State pension fund. However, public employee advocates are concerned that this victory will be short-lived.

More and more, public employers view retirement savings trust funds as slush funds to be used to offset government program costs, to shore up failing businesses in the State or to provide capital for risky enterprises. Public officials have diverted funds to highway maintenance; trust funds have been invested to sustain failing savings and loans; and these funds are being targeted by Governors as sources of capital to entice business into their States. For example:

- The Kansas Public Employees' Retirement System was used to provide funds to prop up failing in-State thrift institutions.

- The Maryland public employees' retirement fund is the subject of current pressure from the Governor to help fund new high-tech ventures in the State.

- In West Virginia in 1989, a court-ordered audit revealed that the State's Public Employees' Retirement System had been shortchanged at least $86 million by the State Legislature. The ruling sustained allegations by a State employee union that the money had been diverted to finance highway maintenance projects and other government expenses. The audit also uncovered that the State Department of Human Resources had made no contributions to the fund in three years.

- In 1985, Governor Bill Clinton of Arkansas proposed and the legislature approved a law recommending that the Arkansas public employee pension plans invest between five and ten percent of their assets in home State ventures. As a result, the Arkansas Teacher Retirement System made a $5 million loan to a hotel with a 23 percent occupancy rate; loaned $300,000 to expand a sorority house; and loaned $7.3 million to Winthrop Paul Rockefeller for a car dealership.

- Last summer in Illinois, the State Supreme Court temporarily barred the State from using $21 million in state pension assets to help balance the budget.

- In New York City, Elizabeth Holtzman, the Comptroller, has proposed using city pension funds to finance pay raises for teachers and to hire additional police officers.

NEW YORK

In 1990, New York State virtually eliminated its contributions to the State pension fund as part of a $994 million set of pension changes. These pension-related changes accounted for approximately half of the savings needed to eliminate the State budget deficit, including $385 million based on optimistic interest rate assumptions.

The rationale for this action is contained in "The Report of the (New York) Governor's Task Force on Pension Fund Investment" in 1989. In a June 21, 1989 press release, Governor Cuomo adopted the recommendations of his task force, which proposed using public as well as private pension trust assets to fund government programs. At a press conference, he referred to the $2 trillion in public and private pension plans by saying:

> ***In this State, we have great debt, a great demand. We need wealth, and there it is: nationwide, $2 trillion worth of it.***
>
> ***These funds, both public and private, receive enormous tax breaks. We all, therefore, have a right to be heard on the subject of how they use our money.***
>
> ***We have hundreds of billions of dollars and we can't find money to build jails....We have hundreds of billions of***

> ***dollars and we can't find money to build roads and bridges.***
>
> ***I mean, you can't make a deal? You can't sit down and say this is interesting.... We're interested in using the pension fund.***

Mr. Chairman, I offer for the record of this hearing a copy of the Governor's task force report (Exhibit 3); his June 21, 1989 press release along with excerpts of his transcribed remarks at the press conference (Exhibit 4); and a response to the Governor's task force report by the Retired Public Employees Association, Inc. (Exhibit 5).

In addition, I would like to submit for the record of this hearing a commentary on Governor Cuomo's proposal (Exhibit 6) prepared by Joseph Wyatt, fiduciary counsel for the California Public Employees' Retirement System. Mr. Wyatt says, in effect, that the Governor's proposal runs squarely against laws pertaining to trusts.

There are other examples of underfunding or directed investments that would violate ERISA. However, I would like to explore in some detail case studies of abuses in Texas and California.

TEXAS

Just a few months ago, the Texas State Comptroller proposed placing the actuarial functions of the State's two largest pension funds under the control of the Governor, Lieutenant Governor and Comptroller (within a new entity to be known as the State Pension Funding Committee) instead of the independent boards that currently oversee the funds.

A public plan's actuary makes the critically important assumptions regarding investment income and benefit costs to the trust fund. The annual contributions to the fund by State and other public employers are calculated on the basis of these assumptions. With the actuary under the control of the employer, there is no accountability to the plan, Board or the beneficiaries.

Thus, the actuary is free to make politically motivated assumptions regarding plan earnings, and thereby, give credence to reduced contributions into the fund by the State and local public employers.

Although the proposals to establish a new State Pension Funding Committee and takeover the actuary were not successful, a recent special session of the Texas legislature did approve reducing funding to the two retiree plans by the requested $142 million over a two year period. We expect that Texas politicians will make another run at the retirement savings trust funds in the future.

In behalf of our affiliate, the Texas Association of Public School Employees, we do not want this to happen. Public school employees in Texas are members and beneficiaries of the Teacher Retirement System of Texas, one of the primary targets of the Texas Comptroller. We agree with the Board of Trustees' July 10, 1991 position paper (Exhibit 7) which expresses opposition to this and other proposals which said:

> ***The state constitution places management of the pension trust fund in the hands of a board of trustees. Trustees have the fiduciary responsibility of loyalty and care in exercising that management for which they are personally liable....Any attempt to transfer this fiduciary duty would be of dubious constitutionality and contrary to established pension trust law principles.***

The Board said that the proposed State Pension Funding Committee would, in effect, constitute control of the plan by the employer. Such control by private sector employers is prohibited under ERISA and the Board said that it also may be prohibited by the Internal Revenue Code:

> ***The recommended change raises serious tax qualification questions under Section 401(a) of the Internal Revenue Code because the fund would no longer be administered in the exclusive interest of the participants and beneficiaries.***

A second element of the proposed takeover of the worker trust fund has to do with control of the operational budget. Currently, the Teacher Retirement System of Texas obtains its operational budget from the earnings of the plan, not from state general funds. The Texas Comptroller wants to make the operational budget of the plan a part of the appropriations process. Of this, the Board of Trustees said:

> ***Pension systems are unlike other state agencies in that they are under the direction of a board of trustees entrusted with exclusive obligations of loyalty to and care of the trust fund. The trustees bear a personal liability for the integrity of the fund and are legally charged with***

> *operating the agency solely in the interest of the beneficiaries for the exclusive purpose of providing promised benefits to participants and defraying reasonable expenses.*
>
> *....Trustees have the authority and fiduciary duty to make the necessary expenditures from the fund to carry out the purpose of the trust. Constitutionally, trustees are made responsible for administering the pension systems. These funds are not state funds; rather, they are private funds under the control of the trustees who are responsible to elected officials but who are primarily accountable to the members and annuitants.*
>
> *Placing the budget under the control of the appropriations process supplants control of the funds by trustees, who bear fiduciary responsibility for their disposal, with a potentially politicized process.*

The Texas legislature's cynicism in these matters is reflected by its effort to gag the trustees. In diverting funds from the pension plan this year, the legislature passed a law that provided:

> *None of the funds hereby appropriated, or dedicated by constitutional provision, may be extended for lobbying on behalf of the Teacher Retirement System or the constituency which it serves. Such prohibition shall include, but is not limited to, correspondence or mailings and telephone solicitation encouraging members and other interested individuals to lobby the Legislature or general public in its behalf.*

CALIFORNIA

While the Texas Teachers are threatened with the loss of control over their own budget, plans in California never have had such control.

Take the California Public Employees' Retirement System (CalPERS), which serves 750,000 active employees of the State, the State universities and 2,300 local government entities such as school districts, as well as 250,000 retirees and survivors. Many thousand active members and beneficiaries of CalPERS are members of our affiliate, the California School Employees Association.

Through most of the 1980's, the workload of CalPERS increased, but the size of the staff has not expanded at a rate to meet the challenge. For example, in the 1986-87 fiscal year, 765 CalPERS employees provided services to less than 800,000 persons in the plan. By the last fiscal year, only 44 more employees had been added to provide services to 150,000 more persons.

Notwithstanding the fact that the cost to administer CalPERS comes from its earnings and not from the taxpayers or the State general fund, the Legislature and the Governor control its budget.

Over the years, the Legislature would authorize and appropriate funds for added staff and the Governor would sometimes even sign such legislation. Too often, the Governor's Department of Finance would override the law and not allow CalPERS to hire added personnel to meet its ever increasing workload.

As a result, people -- particularly the disabled and senior citizens -- pay the price in the form of cruel delays.

Some 40 percent of all applicants for disability and 35 percent of all industrial disability applicants are off the payroll for at least six months before they receive their first retirement checks -- all because of the caprice of the Department of Finance bureaucrats who will not allow CalPERS to hire a few employees.

For one woman at least, the delays pushed her onto the welfare rolls. Beginning in May, 1990, she has engaged in a fruitless series of efforts to get through to CalPERS. In September, 1991, she wrote:

> *I am losing everything I own. I am selling what few household possessions I have to pay utilities and house payments, and I am still 2-4 months behind in these.*

Another retired public worker writes on September 25, 1991:

> *In early April I applied for retirement to be effective August 1. Since that time I have spent considerable time and money in long distance phone calls to complete the terms....I have been told variously that my file was misplaced, that forms need to be processed, and that my settlement would be speeded through....Most recently when I called I was told that it would take another three weeks....I was further delivered a short sermon: There are retirees who have waited longer than I have and in direr straits (How did she know what I was living on these last two months) so I had better prepare to wait.*

The shortstaffing of CalPERS is also resulting in the plan being defrauded. Actual retirement benefits -- the pensions -- that retirees receive are based upon a formula that involves their pay and length of service.

From time to time, some public employers, particularly small ones, such as fire districts, will inflate their payroll records so that a favored retiring fire chief, for example, can get a bigger pension.

One such example involves a fire chief who is receiving a pension of more than $70,000 a year, which is several times his actual salary when he worked for a small fire district in the Sacramento area.

There are today only eight payroll auditors charged with reviewing the payrolls of 2,300 employers of 750,000 persons, increasing at a rate of 18 percent per year. These few auditors can conduct only limited, cursory reviews. And their duties grow each month with 1,600 new retirees. CalPERS estimates that losses in the many millions could be recovered with the addition of only six auditors. Although the Legislature appropriated the funds for these auditors and the Governor signed the law providing for them, the Governor's Department of Finance will not grant final approval.

This severe control by the State is impairing the exercise by the Board and its staff of their fiduciary duties to administer the plan for the exclusive benefit of active workers and retirees. CalPERS is doing the best it can but it needs help.

Last summer, the Governor took steps to assert even greater control over CalPERS.

He sought without success to sack the current Board of Trustees and stack it with his own puppets. Currently, a 13-member Board oversees the operations and investments of CalPERS. This board consists of 6 members elected by active and retired employee groups, 4 members appointed by the Governor, 1 chosen by the State Legislature and, finally, the elected State Treasurer and Controller.

Pete Wilson said that the Board was not accountable to the taxpayers. The record provides evidence of a different story. In 1966, for each dollar of revenue paid into CalPERS: 34 cents came from employees; 39 cents from employers; and 27 cents from investment income. Today, for each dollar of revenue paid into the plan: 11 cents comes from employees; 18 cents comes from employers; and 71 cents comes from investment income.

The earnings on CalPERS investments, which have not included junk bonds or leveraged buyouts, have actually reduced the employer contributions to the plan. Indeed, in the past 5 years, employer contributions have been reduced by

$2.1 billion because of CalPERS investment performance. In the past 10 years, the State employer's rate, alone, has been decreased 38.5 percent.

With the help of the Legislature, the Governor last summer eliminated two supplemental accounts containing $1.6 billion. The earnings from these accounts were used to restore the purchasing power of pensions paid to the oldest and poorest retirees. Wilson did not actually remove the money from the trust fund. As the State employer, he claimed these funds as credits against future employer payments into the plan.

In addition to several other complex changes made in benefit structure formulas, the Governor was also successful in stripping from the CalPERS Board the authority to choose its own actuary, and instead, placing that responsibility in the Office of the Governor.

Some pension experts believe that an actuary controlled by the Governor will result in nearly $500 million in reduced contributions to retirement systems in the next year.

In California, public employees are not taking this usurpation lying down. Led by the California School Employees Association, public employees have filed suit against the Governor to prevent his expropriation of CalPERS funds, to nullify the changes made to the retiree benefit structure and to return the authority to appoint an actuary to the CalPERS Board where it rightfully belongs.

Mr. Chairman, I have provided examples of proposed and actual raids by States led by Democrats and Republicans alike. Certainly, there appears to be bipartisan disregard for these trust funds.

Under State Constitutions and statutes across the nation, public employee retirement funds are to be used exclusively for retirement, disability, death and survivors' benefits and for the administration of the pension plans. Nevertheless, elected officials sworn to uphold their constiutions and laws are simply ignoring them.

RECOMMENDATIONS

In State after State, public employee retirement trust funds are under attack. There is no Federal law to which we can turn to protect ourselves. There are no ERISA-like protections.

The American Association of Classified School Employees recommends that the Congress consider adopting legislation to protect worker retirement trust funds from the raids of Governors and other public employers. We recommend that the legislation include the following:

1. Fiduciary and prudence standards.
There should be uniform, national standards of conduct for fiduciaries, specifying that their obligations as trustees are to make decisions for the exclusive benefit of active participants, retirees and their beneficiaries. Furthermore, the legislation should contain a "prudent person" rule. Both of these standards are contained in ERISA.

2. Uniform reporting requirements.
While plans can use generally acceptable accounting standards, it is important for workers (who do not have the skills of financial analysts) to be able to compare and contrast the investment performance of their plan to other plans. Therefore, there should be uniform reporting requirements to enable "consumers" to judge the investment performance of their pension plan.

3. Exclusive benefit rule.
The plan should be administered for the exclusive benefit of active participants and retirees. This principle is basic to ERISA.

4. Authority of plan trustees over plan administration.
Decisions with regard to plan administration, including expenditures for administration, should rest solely with the Board and not be subject to the approval of employers. However, plans should be subject to employer audit and oversight.

5. Penalties.
Personal civil and criminal penalties should be imposed for breaches by fiduciaries, including actuaries, as well as any person who impairs or impedes fiduciaries in their implementation of the exclusive benefit rule, such as a representative of a public employer -- Governor, County Chief Administrative Officer, School Board Member or Administrator, or City Finance Officer.

6. Enforcement through the Federal Courts.
Any employer, active employee, retiree, beneficiary, or organization of such persons should have standing in Federal court to obtain enforcement.

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Chairman ROYBAL. Thank you, Mr. Schneider. Your entire written testimony will appear in the record. I would like to start the questioning off by asking Dr. Mitchell a question with regard to the fact that there is no centralized reporting requirement in place at the present time. Now, my question to you is how would you structure a national system to collect uniform statistics on public pension plans?

Dr. MITCHELL. I think that a good place to start would be to look at some of the reporting requirements in ERISA. I understand that there are a number of other issues where ERISA application becomes much more troublesome. But with particular regard to the reporting, I think, for example, asking tax qualified public plans to fill out and send in 5500 forms which are the standard reporting forms that private sector plans have to send in would be greatly beneficial because this indicates what amount of assets the plans have, what types of liabilities they have, the numbers of retirees, the actuarial assumptions that are required in estimating liabilities and contributions. This would be a good place to start.

Chairman ROYBAL. All right.

Dr. MITCHELL. We have now seen the Department of Labor get to the point where they have computerized the submission and tallying of 5500 data in the private sector. I don't think it would be terribly expensive to also move that over to the public sector.

Chairman ROYBAL. I am going to ask each one of you later on a question that was asked of me as we went out to cast a vote, which was, "what are we going to do about all of this?" Well, we are going to ask for your recommendations. You have given us some recommendations already in writing, but perhaps there is more that you might want to add verbally. And I will come back to each one of you on that one question. But for the time being, I would like to ask Mr. McEntee to summarize the bad fiscal conditions that one finds the States in. It seems to me that most of these States are looking for revenue from somewhere, and that they are almost bankrupt, so they are taking or dipping into these pension plans. Is that the condition generally?

Mr. MCENTEE. Well, you asked me to sum it up. Let me sum up the condition of the finances of State governments in a very general way. With the rare exception of maybe Hawaii and two others, the situation at this time in our country is disgraceful. It is disgraceful for a whole variety of reasons, including Federal programs put back to the States and not enough funding, the recession, the burgeoning correctional and inmate problem, the whole variety of other reasons that States find themselves in, just a disgraceful fiscal condition, that we are in at the local level.

As you heard earlier, what they are doing is dipping into these pension funds, to these dollars. When I heard the private sector mentioned earlier today and that they are allowed to do certain things, particular employers, well, I think it is important to keep in mind that most of the pension systems in the private sector are non-contributory. Most of the pension systems in the public sector are contributory. In other words, in the private sector they are making unilateral decisions by employers to dip into these funds, and in the public sector usually one-third or thereabout of those funds are employee contributions to those funds. So it is not the same.

Another point I would like to make in regard to that is, and someone once said if we don't learn from history, we bear to repeat it. All you have to do in terms of what is happening now is go back to the Depression, back to a similar time that we now have in our country back to the 1930's, and we found public employers doing exactly the same thing. They did not make their contributions to pension systems all across the country.

I remember a particular Philadelphia case from that time. Philadelphia found itself with difficulty financially and then did not make adequate contributions to the pension system. As a result they tried to decrease benefits. Then it was found, and someone mentioned this morning it will be our children and grandchildren that pay the price for this at some point in time, that Philadelphia by virtue of a Court case, brought by this union, that Philadelphia had to bring their contribution up to an actuarial base that made some sense. As a result, they had to raise taxes. Many of the States, cities, local governments, and school districts find themselves in exactly the same place today, and that is exactly what is happening.

Another point I would like to make because there was such reference to States here, is that we have great problems in States, but in most States at least we have competent administrative personnel that are involved in running and overseeing the pension systems. We have thousands of local governments where the pension system is run by possibly the country clerk or the personnel director who has no expertise at all in terms of the system. So it is not just a State problem, but it is magnified by thousands of local government not even having the minimum expertise that now is involved in the State.

Chairman ROYBAL. Thank you. I would like to actually go back again to the same question. We are told quite often that—and this argument is sometimes raised against the need for Federal standards governing State and local public pension plans—we don't need any more laws, that we have State laws that are sufficient. What is your opinion of that, Mr. Cordtz?

Mr. CORDTZ. Well, I feel, as all of us who have already testified, that it is vitally important that now existing Federal laws, ERISA, et cetera, that are on the books could be made applicable to the public sector. And certainly the thing that we have to sell to the Congress is the fact that there should be not only provisions made that this would happen but that there be funding for the enforcement of it. We have many laws on the books today covering various facets of employment, but especially the one we are addressing today on pensions that there is no provision.

Mr. McEntee just referred to actually millions of people in small communities, counties, States, cities where there is a lack of management of these funds. The accountability or the total amount as estimated in my earlier remarks of $800 billion is what we know. There are probably half again that amount of money that we don't know about, and there is no accountability. And those poor people in the public sector are not able to have any insurance to the fact that they will never be given a pension plan when they are entitled to same.

Chairman ROYBAL. Mr. Schneider, do you agree with that?

Mr. SCHNEIDER. Mr. Chairman, what we believe is that there is a need for legislation. We believe that legislation is necessary to create fiduciary and prudence standards such as in ERISA. We believe there should be uniform requirements for reporting. There certainly should be an exclusive benefit rule, and we also feel that there should be penalties imposed on fiduciaries. who are in violation of the standards set up. We do feel, however, that the jurisdiction should provide people such as employees, retirees, employee organizations with standing to sue in Federal Court to obtain enforcement of these provisions.

Chairman ROYBAL. Then you would extend that to permit suing in Federal Court?

Mr. SCHNEIDER. Yes, sir. We would ask for a standing to sue on the Federal statutes.

Chairman ROYBAL. Because that is something new that has been brought up before this committee which I think makes some sense.

Mr. SCHNEIDER. Yes, sir.

Chairman ROYBAL. Mr. Stark.

Chairman STARK. Thank you, Mr. Chairman. Arnie, I want to just follow that along because it is one of the things that troubles me, and it is my inability to understand the legal system herein, and I think Mr. Wyatt referred to it earlier. I am in somewhat of a quandary as to what we should do. I am not unmindful that we could cause more problems than we could solve with capricious legislation.

And I think it is key, and I would ask all the witnesses, and I think the Chair would be willing to keep the record open, to submit to us after the hearing any specific recommendations that you might have for what type of Federal legislation would help to solve the problem. And as I say, I warn you all that with 50 different States and 50 different sets of laws, that is not going to be technically an easy—something easy to account it. I do like, Arnie, your suggestion of giving the people standing to sue.

Until a few weeks ago, I had a great deal of confidence in the Federal Courts, and often they can act more expeditiously than we can, and they often will take a judicious approach. So that I am amazed at the results that can come out of Court, and I think that that may be a quicker and more effective way for a variety of State plans to get equity. But, again, I am not sure how we would approach that. Not being a lawyer, I would imagine we would get involved with the Judiciary Committee, but I don't know. And I would look to the people that had interest in the hearings today to submit to us because I think you have heard from all of the witnesses today on both sides of the aisle that there is a broad concern. And I would think that legislation of this nature that would give standing to sue, for example, which would have little Federal budget impact. We are looking around for things to do that don't cost money. That is a welcome sort of a project in this town these days. So to the extent you could provide us with some suggestions, I would appreciate it.

But, secondly, I would like to try something, Arnie, with you. And the reason I want this is we are going to, probably as a result of these hearings and your prepared testimony, begin to look at some of the aggregate problems. And I hope we can get a copy of Joe's chart which shows the California problem in a graphic sense. So we will have some great economic data here as to what is happening in a variety of States. But let us go back now just for a moment to help us in explaining this to our colleagues to the 30-year school district employee who you said comes out of the system with $5,600 a year in a pension. Would it be fair to assume that that person at whatever level of salary they had been would qualify for anywhere near the maximum Social Security benefits? Let us assume that California had been doing the right thing in paying in the Social Security all these years, but in a sense would they be anywhere near a thousand bucks a month in Social Security payments today? Maybe one of your colleagues there who is shaking his head might have an idea. I don't know. 600 bucks? I am trying to—

Mr. SCHNEIDER. I am advised it is closer to five.

Chairman STARK. All right. So another $6,000 in Social Security. So we are talking about someone who is looking at slightly under $1,000 a month in an aggregate pension. Let us back up if we can think back to where that person was. The person who entered the system in 1980—this same employee—what would their aggregate pension starting in 1980 and aggregate Social Security have been about then? Just make a guess.

Mr. SCHNEIDER. It is beyond my area of expertise I must confess, but we are going to get some information.

Chairman STARK. But I think you are going to get some expertise handed to you.

Mr. SCHNEIDER. We have about $300 to start.

Chairman STARK. On a pension?

Mr. SCHNEIDER. Yes.

Chairman STARK. A month?

Mr. SCHNEIDER. Per month.

Chairman STARK. All right.

Mr. SCHNEIDER. And Social Security about $500 per month.

Chairman STARK. On Social Security?

Mr. SCHNEIDER. Yes.

Chairman STARK. All right. Now, if the system had worked the way it is supposed to work in California, you had somebody retiring in 1980 with their Social Security is, obviously, indexed and might be a good bit higher today. Where would the $300 pension be for that person today 10 or 11 years later that started at 300 if the system was supposed to work before the governor dipped into the till?

Mr. SCHNEIDER. Well, what would happen there is that the cost-of-living provisions that Mr. Wyatt showed us this morning that used to be there would have come into give, approximately, 80 percent of what they have lost to cost of living.

Chairman STARK. Do you want to guess what that would have raised that 300 to today?

Mr. SCHNEIDER. Oh, about 500.

Chairman STARK. So almost or a little higher actually than the person starting today?

Mr. SCHNEIDER. Yes.

Chairman STARK. All right. So what we are talking about is the munificent sum of 200 bucks for somebody arguably who even if their Social Security through the COLAs had gone to a thousand is still living at not two times the poverty level of the State of California. Now, let us assume for a minute that they were wise and they own their own home. Even that to put it into the context of another problem that Chairman Roybal and I face all the time is this person who retired in 1970 might have $15,000 a year in retirement income out of which if they own their own home free and clear, they would be paying taxes. Even at Prop-13 levels they would be paying insurance, utilities, and whatever else. Can you tell me how you advise your members if the average nursing home cost in California just for rock bottom is 2,500 bucks a month—how do these people manage to qualify? They are too rich for Medicale. What do you tell them? How do they make this thousand bucks a month pay a $2,000 a month—and that is if you can find a decent nursing home at that in California—what do you tell your members to do?

Mr. SCHNEIDER. Mr. Stark, what happens is the people are living at near or below poverty level, that they just cannot make ends meet, and it is almost an impossible situation for them.

Chairman STARK. So this is not Ivan Boesky?

Mr. SCHNEIDER. No.

Chairman STARK. This is not Donald Trump.

Mr. SCHNEIDER. No. We are talking about the lowest paid workers. We are talking about the little people, and we heard a lot of testimony this morning about who would pay for it 30 years from now, et cetera. Well, I am going out every day and meeting people, workers in the schools who—they don't know about the fiduciary standards. They don't know about actuaries. They know that they are scared. And what they read in the paper scares them.

Chairman STARK. Well, let me just get a scenario of the people in the State who are being denied services and paying for this. We have increased the tuition in our State universities. As far as you know that is correct?

Mr. SCHNEIDER. That is correct. I have a son there.

Chairman STARK. We have frozen the wages of most school employees. As far as I know that is correct. We are denying the expansion of highways and rebuilding earthquake damaged facilities. We are not going to allow the new retirees an increase in their pensions. So I guess what I am trying to paint a picture, what is your average non-certificated school employee make in our area, in my district where you live? What do we pay a cafeteria worker or a school—

Mr. SCHNEIDER. I am going to take a guess. If we put in everybody, the average is probably going to be, and this is ballpark, in the $7,000 to $8,000 range—in that vicinity.

Chairman STARK. A year?

Mr. SCHNEIDER. Yes, because remember we are talking about people who are also working less than 40 hours a week.

Chairman STARK. Okay. So we have some of the richest people in California whose wages are frozen, whose chance at a cost-of-living increase is being eliminated, and it is kind of tough to live in our area on $7,000 a year. I can't help but just make an aside here, the only suggestion we are getting from the White House is that we lower the capital gains tax. Now, if you can get me from that kind of an economic suggestion to how I could deal with this person who is making 7,000 bucks a year, I would like you to, but please do it later in writing because my eyes would glaze over.

All I am trying to do, and see if I am right, is that we are dealing here with some of the least adequately paid people. And even if you take some, I suppose, of our highest paid jobs in California other than executive jobs in the State service might very well be our highway patrol of whom we are very proud. It is probably a good job. It probably pays well. It probably has a high burnout rate. But these are not munificent pensions. Is that a fair statement?

Mr. SCHNEIDER. That is absolutely—

Chairman STARK. And the only hope has been that we have been lucky and we have invested the money in California well so not that we have been able to pay people more than they anticipated, but we have just been able to almost keep up with inflation by using the extra money that the governor now is taking to cover the deficit. Is that a fair—

Mr. SCHNEIDER. That is a fair statement.

Chairman STARK. I think that it is incumbent on all of you, if you can, to give us more examples because this stuff is pretty complicated for those of us who don't deal in these sophisticated numbers very often. Albeit, we risk the chance of it being called anecdotal, it is still important; I mean, for each of you who come from other parts of the country to make sure that the Members of Congress who represent you get a sense of who the folks are in their districts who are impacted on these problems because I am sure each State will be different. I happen to have a very parochial interest in what is going on in my home State right now, but as we have heard today, it is going on. And the temptation for other States—I mean, this is a kind of viral idea that could spread much more rapidly than I think any of you at the witness table would like to see.

I just want to conclude by first of all thanking you for calling this to our attention because it isn't something—I am sure a lot of your members haven't figured out how they are being impacted, and they won't figure it out, unfortunately, till they have been retired for 10 or 15 years in California, and also they figure out they are a whole lot poorer than they thought they were. And then they are the least able to correct that. They are the most fragile, the least able to go back into the workplace and even if times picked up and supplement their savings. We need anecdotes in terms of how this impacts people in Texas and in Mississippi and in Pennsylvania, in Oregon, in New York State because whatever we can figure out to do to assist you, I am afraid we are going to need enough votes to have a veto-proof vote. And we will look forward to your help in that regard.

Mr. MCENTEE. Could I just add one statement to that?

Chairman STARK. You sure can.

Mr. McENTEE. The economic scenario that you present, as devastating as it is in California, and we will be glad to provide you with some data if you wish, is worse in so many other places because there are no automatic cost-of-living adjustments in the majority of pension plans across the United States for the public sector. What happens in many States and local governments is that you have to go back to that city council or you have to go back to that State general assembly, and they have to pass a separate bill maybe every 2 years or maybe every 4 years to give some kind of cost-of-living increase to these people. As a result, we have people out on pension for a number of years so far behind the rise in inflation that it is almost incredible that they survive.

If I could make one other point. Someone asked earlier about people being affected and whether or not they can actually lose pensions. AFSCME represents the city employees in Bridgeport, and as the Congresswoman earlier this morning mentioned Bridgeport. In Bridgeport, as you probably do know, the mayor filed for bankruptcy. We were involved in the Court proceeding, and thus far we have won the case, and they have not been declared bankrupt. What is important in that regard is this is all uncharted territory in terms of the law. There are no bankruptcy protections for the workers in city government and in State governments as there are in the private sector.

And one of the questions when you say, well, maybe your own members don't question this or don't know about it or maybe they are not as concerned as they should be, well, our people in Bridgeport were very concerned because in the laws of Connecticut they are not insured investors. They are not on that list of protected individuals. So theoretically had they been able to go into bankruptcy, we have no idea what would have happened to the pension of somebody who has 24 or 25 years in as a city employee.

Now, once again, it would end up in the Courts. Maybe you have confidence in the Courts, but our confidence is lower than yours. And maybe they get 15 cents on a dollar. Maybe they get a quarter on a dollar. And these are the kinds of things we worry about. There are people in Bridgeport who have already given up $4,000 in terms of wages and their fringe benefit packets just to keep that city alive. And now there was a strong possibility that pensions they had accrued, years of service, and a social contract between the city and those workers could be broken by virtue of bankruptcy.

Chairman STARK. Well, as you say, it is a scary proposition, and I hope that we can find a way. As I say, right now I think our dilemma is what type of legislation can—I mean, there is a certain pressure. There is a certain amount of just calling attention to this and hoping that you can embarrass enough State governments to do the right thing. But beyond that, it seems to me—

Mr. McENTEE. We have tried that. We have tried to embarrass them, and it doesn't work.

Chairman STARK. And sometimes that is pretty tough, isn't it?

Mr. McENTEE. Yes.

Chairman STARK. So we will try, and as I say, the admonition is I don't want to end up, you know, causing more problems than we can solve. So we do look forward to the expertise that has been displayed here this morning to help us figure out what legislation would be most useful in solving this problem. Mr. Chairman, I thank you for your indulgence.

Chairman ROYBAL. Thank you. Mr. Schneider, do you have anything to add to all of this?

Mr. SCHNEIDER. Yes. I did want to follow up very quickly on one point that Congressman Stark made. Mr. Stark, you talked about the members of our association as probably not even being aware of what is happening. But certainly as you know, in California the people became aware because organizations such as ours and people such as yourselves, the Congressmen of this committee, have made them aware. There are other places where they are not aware, and attempts to make them aware have been met with some great cynicism.

I have a copy of a newsletter published by the Teacher Retirement System in Texas dated July 15th, 1991, where the Teacher Retirement System responded to raids and an attempt to usurp the trustees' authority to be able to manage the fund themselves and a power grab such as we saw originally in California. And the response by the legislature in Texas was to add a section to their funding bill that said, "none of the funds hereby appropriated or dedicated by constitutional provision may be extended for lobbying on behalf of teacher retirement systems or the constituency which it serves."

That is not the best part. "Such prohibition shall include but is not limited to correspondence or mailings and telephone solicitation encouraging members and other interested individuals to lobby the legislature or general public in their behalf." That is what we call a muzzle where I come from. And it is very, very disturbing. And part of our recommendation is to remedy that by putting the operating budget and the administration of the plan in the hands of the board of trustees of the plan.

Chairman STARK. I wouldn't worry about that. We have had that restriction in the defense budgets for years saying that defense contractors can't spend any of the Federal dollar to lobby Congress, and if you believe that hasn't happened, you got another guess coming. So ignore that one, and figure that a cause will be heard in spite of what the Texas legislature may try and do.

Mr. CORDTZ. Mr. Chairman, if I may have just a moment?

Chairman ROYBAL. Yes, Mr. Cordtz.

Mr. CORDTZ. Without taking more of the committee's time, I have a publication here, and when you asked for further information, it happens to be the myths of State employee pensions. And that is produced by the California State Employees' Association. We happen to represent a large number of those people. But there it tells in detail and the problems of the individuals who are now on pension over various spans of time; 12 years, 35 years, different jobs and circumstances, husbands or wives who have become ill and had to leave. And we would like to share that and whatever other information.

Chairman STARK. Yes. As I say, if we could take parts of that newspaper leaving out the ads placed by Republican candidates for re-election and put it in the record, I would ask the Chair for unanimous consent.

Chairman ROYBAL. All right. Without objection. That will be the order. Yes, Dr. Mitchell.

See Appendix, p. 180, for supplemental material submitted by Mr. Cordtz.]

Dr. MITCHELL. I wondered if I could just support and, in fact, add to some of my colleagues up here. I think that individual representatives from certain States or certain groups give their picture. What is still missing is an overview of what the whole system looks like. And part of that problem comes about because we don't have full information on what the public sector arena looks like.

A recent survey pointed out that 6 out of 82 State plans and teacher plans surveyed don't even have enough assets to pay their current retirees, and that 40 out of 82 State and teacher plans including the District of Columbia have insufficient assets to meet their projected benefit obligations. So this isn't just one or two.

Chairman STARK. Would those plans have a claim? Would they have a claim on the current entity? I guess it depends on if the plan was a contractual plan with a city or a county, the county doesn't have enough reserves, would many of those plans have a claim against the body that was the original—

Dr. MITCHELL. Well, the one that is in the worst shape apparently is the West Virginia Teachers Retirement System which has 14 percent of assets needed. It is the one that is going to go broke first. This is not a question—

Chairman STARK. Claims in West Virginia against the government there.

Dr. MITCHELL. Well, no. Oh, are you asking a claim vis-a-vis the Federal Government? Is that your—

Chairman STARK. No. I mean, would the workers—let us say they work for the fire department in West Virginia. Would they have a claim against the city or the county that the fire department—

Dr. MITCHELL. Many States give constitutional rights to their employees. Others don't. But I think it also redounds to the issue of a social contract. When you are promised a pension, most people expect that within reason they will get pretty much what they have been promised. And this is case where the day is upon us fairly soon.

Chairman STARK. Well, we did that, or the Courts did that recently in retirees' medical benefits. And they determined to the dismay of many of our large corporations that where people have been led to expect them even though it was contractual before they began to pay them, the companies had an obligation to continue this. And I fail to see that sort of thing continue.

Dr. MITCHELL. Well, this is true under ERISA for the private sector, but I am glad you mentioned this because I think that is the next looming problem, that States and public sector employers have not prefunded their health benefits for retirees either.

Chairman ROYBAL. Well, Dr. Mitchell, you State in one of your recommendations that the General Accounting Office undertake a study of public pension plans to establish their current status and to establish a profile of the types of practices followed by public sector employers. Now, before the Congress does anything, do you recommend that we actually ask the GAO to conduct such a study?

Dr. MITCHELL. I think it would be a wonderful idea. The last serious study that was done was back in the late 70's. No one has taken a broad view of what public sector pensions look like, and I would heartily support that.

Chairman ROYBAL. And who did the study in the 70's?

Dr. MITCHELL. I beg your pardon?

Chairman ROYBAL. Who did the study in the 70's?

Dr. MITCHELL. Let us see. Ray Schmidt who is here can speak to this. I believe he had a large hand in it. It was a congressional research service as far as I know.

Chairman ROYBAL. But studies have been made, have they not?

Dr. MITCHELL. No—

Chairman ROYBAL. But they are not—

Dr. MITCHELL. [continuing] nationwide study of public sector plans as thorough has been done. There are a few organizations that have collected 80 plans here, 100 plans there. But no one has a thorough understanding of all the several hundreds, if not thousands, of plans.

Chairman ROYBAL. I am asking these questions because I think it is most important that we get started in the right direction. It is the intention of the committee to make recommendations regarding legislation on this subject matter. But before that is done, I think we have to get all the information we possibly can. Now, we are going to take the recommendations that you have made and use them in making a final determination. However, as we go through the recommendations made by each one of you, I find that they are very similar. You use a little different language perhaps, but they are all similar.

For an example, and this is the only example I am going to give, Mr. Cordtz says first we need to ensure that pension assets are used for the exclusive benefit of plan participants and beneficiaries. But Mr. Schneider says it another way. He says these plans should be administered for the exclusive benefit of active participants and retirees. And he goes on to say this principle is basic to ERISA. It is the same thing. And as we go through each one of these recommendations, we find that the only difference is the way they are written. Which leads me to believe that these recommendations that are being made are coming from a cross-section of your community, in this case labor and various other organizations, and that it is a consensus view. We on the committee therefore, must look at this and see what can be done.

Now, before we adjourn, I would like to ask that if you on your way home start thinking of anything that you think you should have said, any information that you might be thinking about at the time, please do not hesitate to put it in writing and send it to the committee. This happens on many occasions.

Mr. MCENTEE. I just thought of something.

Chairman ROYBAL. Very good. Go right ahead. I would like to thank each and every one of you for your attendance, for your participation, and for your willingness to be questioned on this subject matter. I think we have established more or less what the problem really is, that there is a need for some kind of reform. Somebody has got to look after the interests of the people who are seeking a pension. And I think at this time it is the Congress that is going to have to move a little bit. I thank each and every one of you. The hearing is adjourned.

[Whereupon, at 12:33 p.m., the hearing was adjourned.]

APPENDIX I

nea

NATIONAL EDUCATION ASSOCIATION

Keith Geiger, President
Robert Chase, Vice President
Marilyn Monahan, Secretary-Treasurer

Don Cameron, Executive Director

1201 16th Street, N.W.
Washington, DC 20036-3290
(202) 833-4000

December 3, 1991

The Honorable Edward R. Roybal
Chairman
Select Committee on Aging
300 New Jersey Avenue, S.E.
Room 712
Washington, D.C. 20515

Dear Chairman Roybal:

The National Education Association is deeply concerned about the lack of federal standards for state and local public employee retirement systems. We commend you for bringing attention to this critical issue in the joint hearing with the Subcommittee on Investment, Jobs and Prices of the Joint Economic Committee on November 20.

Establishing standards for state and local employee retirement systems would advance several interlocking national goals, including advancing the drive for educational excellence, protecting the retirement security of millions of Americans, and enhancing economic growth.

Enclosed is an NEA statement that we would like to have included in the record of the hearing. Thank you for your attention to this matter.

Sincerely,

Debra DeLee

Debra DeLee
Director of Government Relations

DD:mp

LEGISLATIVE INFORMATION

Statement of the National Education Association
on Federal Standards for Public Employee Retirement Systems
Submitted to a Joint Hearing of the
Select Committee on Aging and the
Joint Economic Committee
Subcommittee on Investment, Jobs and Prices
of the U.S. House of Representatives
November 20, 1991

Members of the Committee:

The National Education Association represents more than two million education employees in the nation's public elementary, secondary, vocational, and postsecondary education institutions. We appreciate this opportunity to speak on an issue of critical concern to our members: the need to establish federal standards governing public employee retirement systems.

Pension benefits of education employees are a basic right, earned for many years of service to the community and the nation. NEA members have been active at the local, state, and national levels to assure that education employees can look forward to a safe, stable, and adequate income that will last throughout their retirement years.

And yet, today many educators are duly concerned that their retirement may be threatened. Far too many public officials are willing to place the retirement security of public education employees at risk for short-term, political gains. Moreover, national and regional economic conditions make raids on public employee retirement trust funds ever more attractive. Consequently, the livelihood of millions of public school employees is ever more at risk.

NEA strongly supports federal legislation, comparable to the Employment Retirement Income Security Act (ERISA) enacted in 1974, that would set standards for valuating public employee retirement systems, clarify fudiciary responsibilities for reasonableness and prudence governing investment decisions, require the establishment of autonomous boards -- majorities of which are elected by and from the membership, and enforce such standards. Federal legislation must not superdrfr substantially equivalent or superior state or local statutes governing retirement systems.

Federal legislation covering public employee retirement systems would advance several interlocking national goals. First, since retirement benefits -- including pension and health care coverage -- are an integral part of the compensation necessary to attract and retain qualified persons to education professions, federal protections would help advance the National Education Goals adopted by the nation's governors and endorsed by President Bush. Second, secure, stable retirement systems that provide state and local employees adequate income and health care coverage far into the future would lessen the need for individuals to resort to federally funded social programs. Third, public employee retirement systems are an important engine driving the nation's economy. Prudent investment of the more than $700 billion presently held by public employee retirement would promote stability and growth and help advance our nation's economic goals.

The enactment of ERISA standards for the private sector came at a time of great economic uncertainty for many American businesses. Staggering oil prices, oppressive inflation, and other conditions propelled many companies to take -- at times -- desperate action that put the retirement security of millions of American workers at risk. The economic conditions for states and municipalities is not identical, but no one questions that the circumstances have forced policymakers to make extremely difficult choices, and many state and local budget analysts feel that they have run out of options.

General economic conditions have led to a reduction in state and local revenues available to meet operating expenses -- to say nothing of providing resources to invest in deteriorating infrastructures. For example, state general fund revenues rose by $9.7 billion or 3.6 percent between fiscal year 1990 and fiscal year 1991, but some $9.5 billion of the increase represented revenue increases, principally increase in sales taxes. Between FY91 and FY92, state general fund revenues rose by $24.8 billion or 9.0 percent, with $16.5 billion of the increase coming from revenue increases, including new taxes.

Even with new taxes, most state and local governments expect they will make mid-year reductions in spending, as they have repeatedly in recent years. Some 27 states had revenue shortfalls in 1991, and some 31 states enacted revenue increases in FY92.

The economic straitjacket in which policymakers find themselves makes the $700 million in public employee trust funds an attractive target. In the past year, at least 18 states took steps to delay, defer, or cancel scheduled payments to public retirement trusts. These short-term savings can wreak long-term problems for future retirees and for taxpayers at large. Not only do delays and cancellations deprive the funds of necessary resources to maintain a stable valuation, but even a short delay deprives the trust funds of investment income, necessitating larger payments out of state and local general funds as retirement benefits come due.

Note well, benefits earned by public employees must be paid. Reductions in contributions to pension systems merely shift the burden to future beneficiaries and/or future taxpayers who must make up the difference, and such reductions can be very expensive. For example, some 58 percent of the income to all state employee retirement systems in 1986-87 came from earnings on investments.

Even more alarming is the prospect that local and state governments will borrow from retirement trusts. Earlier this year, California withdrew $1.6 billion from two funds controlled by the public pension system in an effort to address a $14.3 billion state shortfall.

Moreover, many state budget writers have been adjusting actuarial projections with inflated numbers for investment income or unrealistic projections of future benefit payments to give the appearance that contributions need not be made to retirement trusts. Again, such short-sighted tactics place an inordinate burden on future taxpayers, and place our members and other public employees at serious risk.

In addition, absent prudent investment standards, state and local governments have the potential for tremendous abuse in the cause of "economic development." Using public employee retirement funds to spur growth by itself is not bad, but participants in public employee retirement systems are concerned that such investments are reasonable. Moreover, participants in public retirement systems are wary of using trust funds to advance other public policy goals when those goals are put above the interest of participants.

Budget-writing gimmicks, loose control over retirement boards, and inadequate standards for valuating plans and guiding investments have had a very real impact on the security of public employee retirement systems as of today.

Many state and local governments are already operating such trusts at or below the margins consistent with prudence and reasonableness.

A 1989 NEA survey revealed that the typical public employee trust was less than 70 percent funded for accrued liabilities, an unfunded liability of some $230 billion as of 1988. A comparable study of private pension plans showed that, as of 1985, some 90 percent were 75 percent funded, and more than half have funding ratios of 125 percent or more.

The NEA survey revealed a stark difference in the stability of trust funds limited to participation of education employees compared to funds for other public employees. More than half of the 38 plans limited to education employees had asset/benefit ratios below the national average (18.7 to 1), and five of the 38 plans had ratios of 10 to 1 or below. By comparison, fewer than one-fourth of 39 plans covering educators and other public employees had funding ratios less than 18.7 percent. In fact, the average for such general plans was 24 percent, and fewer than half fell below that standard.

Projections are that the valuation of public employee plans will get worse before it gets better. The more states delay or cancel or borrow public employee trust funds, the less stable such funds become, the less investment income they earn, and the less able they are to provide adequate retirement protection to participants. These circumstances threaten the level of benefits, but they also lessen the ability of such retirement systems to provide adequate cost of living increase or to maintain or expand post-retirement health care benefits. For example, only about one-fifth of teachers and about one-third of public employees are in retirement plans that provide automatic adjustments that fully reflect inflation. Plans without automatic inflation adjustments sometimes provide ad hoc increases, but such ad hoc increases generally are provided based on available funds. With so many plans operating at the margins, cost-of-living increases are virtually out of the question.

The marginally of public employee retirement plans also threatens access to post-retirement health care benefits. Education employees are less likely than private employees to have access to post-retirement health care benefits, but even these are threatened. For example, in 1988 Chicago attempted to terminate health care benefits before agreeing, as a settlement to litigation, to share the costs of future benefits with the trust funds and beneficiaries. Increasingly, public employers can be expected to explore a reduction in post-retirement health care as a cost-cutting option.

In short, most active education employees cannot reasonably expect retirement benefits as adequate as those provided a decade or two decades ago. Ironically, this comes at a time when the American public is demanding higher standards for excellence in education and asking why our society cannot attract to the teaching profession people from the highest levels of academic achievement.

The federal government can and must play a role in advancing excellence in education, protecting the security of public employees, and assuring a stable economy. We commend these Committees for helping bring attention to the vital issues related to public employee retirement systems. And we call on the Congress to take immediate steps to enhance the security of retirement systems, assure fudiciary responsibility of retirement trust governing boards, set standards for valuation and other actuarial projections, and establish strict enforcement procedures to assure adherence to high standards. We pledge to assist in this effort in any way possible.

Thank you.

STATEMENT OF THE NATIONAL COUNCIL ON TEACHER RETIREMENT
SUBMITTED IN CONNECTION WITH A HEARING BY
THE HOUSE SELECT COMMITTEE ON AGING AND
THE JOINT ECONOMIC COMMITTEE
ON THE USE OF PUBLIC EMPLOYEE PENSION FUNDS
BY STATE AND LOCAL GOVERNMENTS
NOVEMBER 20, 1991

We appreciate the opportunity to submit a written statement in connection with today's hearing. The National Council on Teacher Retirement (NCTR) is a national association of 61 public pension funds. NCTR members serve nearly 9 million active and retired teachers and other public employees. As such, NCTR has a tremendous interest in protecting public pension funds assets from incursions by state and/or local governments.

In this statement we will make a number of observations about the current fiscal problems of many of the states, the efforts of some of them to alleviate their fiscal problems by reducing the funding of public pension funds, and the possible legislative and policy solutions to these problems. We should state at the outset that, absent federal financial guarantees of state pension systems, NCTR is unalterably opposed to federal regulation.

Many of our states are experiencing a budget crisis, caused in large part by the federal government's abandonment of its role as the financier of certain services and its transfer of that role to the states. The states are now mandated to continue these services, but without any federal assistance. The National

Conference of State Legislatures (NCSL) estimates that during the last six years, Congress has enacted over 50 major laws that impose federal program mandates on the states. NCSL, as well as the Office of Management and Budget (OMB), have calculated that mandates passed during the last Congress alone will cost the states $15 billion over five years. The cost of mandates for just seven bills expected to pass during the current Congress is $1.6 billion, according to NCSL. The State of Maryland estimates that nearly 25% of its annual budget of $6.5 billion is spent complying with such federal mandates. The State of Tennessee has determined that it will soon be paying over $225 million a year on mandates. And the growth of mandates is not expected to slow.

With overall economic performance weakened, state revenues are insufficient to pay for these federal mandates. Many states are being forced to reduce spending, raise new revenues, or both to offset this shortfall. They have no choice but to take these actions because, unlike the federal government, states must balance their budgets.

As part of their across-the-board spending reductions, a number of states have taken initiatives that reduce their contributions to public pension plans. This has led to suggestions that federal legislation should be considered that would protect public plans from erosion of their assets. It should be noted that federal regulation of public funds has been debated for almost fifteen years, through a series of legislative proposals. [1] In each case, when Congress was exposed to the comprehensive and effective regulation of public retirement systems at the state level, it rejected such proposals. That wisdom is equally applicable today.

As you know, state pension plans are financed by a combination of employee contributions, employer contributions, and the earnings derived from investment of the funds. The states, through their legislatures, appropriate the funds that comprise employer contributions.[2] The amount of the contribution that the legislature must make in any given year depends on many factors, including the interest rate earned on the fund's assets, the plan's unfunded liability, the actuarial cost methods used, employees' salary increases, employee withdrawals from the fund, retiree mortality, and age of retirement. For example, in regard to the interest rate factor, if the pension fund is earning a high rate of return on its assets, it may require a smaller contribution. Conversely, if the rate of return is low, a larger contribution will probably required.

States can lower their contribution rates by altering the foregoing factors. For example, through changes in its

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1/ H.R. 4928, H.R. 4929, and S. 2106, the Public Employee Retirement Income Security Act of 1981; H.R. 5143 and H.R. 5144 the Public Employee Pension Plan Reporting and Accountability A of 1984; and H.R. 3126 and H.R. 3127, the Public Employee Pensi Plan Reporting and Accountability Act of 1985.

2/ For local government pension plans, the city council makes the necessary contributions.

actuarial cost method, the New York State Employees' Retirement System decreased the state's annual contribution from $429 million to $0 from April 1990 through March 1991. The Connecticut State Employees Retirement System changed its actuarial cost method and saved $40 million this year. Its sister system, the Connecticut Teachers Retirement System, saved $32 million this year through a modification in its funding technique.

Some states have taken more questionable measures to reduce their contributions. The most dramatic of these, and the one that spurred today's hearing, was the initiative proposed by California Governor Pete Wilson and adopted by the state legislature, which transferred a $1.6 billion reserve fund of the California Public Employees Retirement System (CALPERS) to the state and granted the governor control of the fund's actuarial functions. Governor Wilson's action is properly under challenge in state court because it impairs the integrity of the fund. [3]

If precedent is instructive, the California court will overrule or modify the Governor's actions just as it did in previous challenges to that state's pension funds. [4]

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[3] Claypool v. Wilson, No. 3 Civ. C011580, filed in the Court of Appeal of the State of California, Third Appellate District on August 1, 1991. NCTR, the National Conference on Public Employee Retirement Systems (NCPERS), seven individual public funds, and the American Association of Retired Persons (AARP) have filed amicus briefs in the case.

[4] Valdes v. Cory, 139 Cal.App.3d 773, 189 Cal.Rptr. 212 (Cal. App. 3d Dist. 1983) and California Teachers Association v. Cory, 155 Cal.App.3d 494, 202 Cal.Rptr. 611 (Cal. App. 3d Dist. 1984).

California, like virtually all other states, has strong laws protecting the legitimate interests of public pension plan participants. The fact that the Governor in times of fiscal distress attempts to ride rough-shod over these laws does not mean that they are inadequate -- or that a federal law would be more effective. Further, should the Governor somehow prevail, the political process, reflected in gubernatorial and legislativ elections or through voter referenda, offers greater likelihood of corrective action than does federal litigation.

The recent election in Maine illustrates the political process at work. The voters there overwhelmingly approved a constitutional amendment that declares funds appropriated to the Maine State Retirement System to be assets of the system and prohibits the funds from being diverted to another purpose. In approving the amendment, the voters expressed their concern that state government should not interfere with the sound operation of the retirement system.

Proponents of federal regulation are using the Governor Wilson example and the budgetary problems of the states as the pretext for a federal regulatory scheme. They are essentially saying, "the existing state regulatory schemes are inadequate if the Governor's trying to ignore them. What is needed is a federal fiduciary duty, enforced by the federal courts. Only this will deter the governors and legislatures from budget reductions that negatively impact the funds." This panacea is being offered while, at the same time, the Congress is increasing the fiscal burden on the states.

As we understand it, this year's proposal for public pension plan regulation will include reporting and disclosure requirements as well as a federal fiduciary duty standard patterned on the ERISA standard, all of which are enforceable by a cause of action in federal court. The federal cause of action will be open to any employer, employee, retiree, or beneficiary as well as to organizations of employees and retirees.[3]

Other provisions include giving the governing board, rather than the employers, sole responsibility for decisions about plan administration, although the plan would nonetheless be subject to employer audit and oversight. A penalties provision would impose personal civil penalties for breach of a fiduciary duty or interference with the performance of such a duty.

The basic argument against federal regulation in both its current and its previous form is that there is no problem of a national dimension in the administration and operation of state and local pension plans. For the most part, state plans are operating effectively, in part due to the comprehensive and effective statutory systems of regulation that the state legislatures have created and are fine-tuning annually to better

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[3] Although this is not NCTR's primary concern, the taxpayers will be less than enthusiastic to burden already overworked federal courts with lawsuits complaining of inadequate reporting and disclosure, particularly in view of the fact that state laws and state courts are more than adequately addressing these issues.

meet the needs of public plan participants, beneficiaries, and taxpayers. State and local pension plans have been around for a long time and these levels of government are experienced in dealing with them.

Not only are public plans well regulated, for the most part, but they also perform well. Public plan coverage of employees is extensive; roughly 90% of all public employees are covered, and most of those covered belong to state-administered systems. Further, public plans generally provide more adequate benefit levels and a broader range of benefits than do their private sector counterparts.

In their long history, not one of the state plans has ever defaulted or terminated. Nor is there any evidence to suggest that terminations will occur in the foreseeable future. If anything, the well funded situation of many of the plans is clearly a bane to them, because their assets look increasingly tempting to state and local governments starved for revenue.

In short, federal legislation is a solution in search of a problem.. There is no serious, documented problem with the regulation or administration of state and local pension plans. The administration of some public plans could be improved, but Congress simply hasn't made a case for federal regulation.

Even if the proponents of federal legislation were able to demonstrate more effectively the need for federal intervention of public pension plans, it is seriously questionable whether this is an appropriate area for Uncle Sam. Principles of

ederalism make it clear that Congress should not interfere with
raditional functions of state and local government, particularly
e manner in which these governments compensate their employees.
is principle has particular force where, as here, Congress is
fering no benefits to accompany the burdens it proposes and
ll in no way be accountable to the public being served.
gulatory responsibility should be assigned to the level of
vernment that assumes fiscal responsibility for the plans.

It is important to note what federal regulation fails
do: it does not provide plan termination insurance, create a
nsion Benefit Guaranty Corporation, or otherwise insure the
scal soundness of public plans (as ERISA attempted to do for
ivate pension plans). Nor does the regulation offer to cure
oblems such as minimum vesting or accrual of benefit standards
s did ERISA), because such protections already exist in state
w.

What would federal regulation do for public employees
d their pension plans? Among other things, it would give the
cretary of Labor broad authority, which invites an ever-
creasing federal role in the operations of state and local
nsion plans. In addition, it would create a federal cause of
tion in an area that is already well defined by state law.

What would these proposals offer the public pension
an community? The heart of the proposals are their
tablishment of reporting, disclosure, and fiduciary standards
r public plans. In many respects these standards are laudable.

The problem is that similar standards are already embodied in state law and all the proposals add is an undesirable uniformi which in many cases will be less effective in protecting the interests of plan participants than are the present practices the states.

NCTR's publication, Public Pension Plans: The State Regulatory Framework, demonstrates beyond question that the complex of laws and traditions that govern pension plans in th states exceed the requirements of any federal regulatory proposal. Imposing a new federal scheme will not provide grea protection; it will simply cost the plans and their participar million of dollars in administrative costs.

The NCTR report points out that state pension plans created by state law, and in some cases by the state constitution. These statutes are, in effect, "the plan." The trustees and employees of state pension funds are subject to a the laws and regulations that govern the conduct of public officials in the state. And all state pension systems are subject to multiple layers of vigorous supervision.

The types of protections include regular audits and actuarial reviews. In addition, many funds are monitored by state level pension review commissions, which are responsible reviewing the overall performance of the funds.

The state statutes that establish the pension system include detailed requirements for their operations. Besides t specific statutes, pension systems are subject to a broad rang of other statutes, including government "sunshine" laws or open records laws that require the pension board proceedings and records be made available to the public (except for members' personal records and certain sensitive investment documents); state freedom of information laws that insure access to board records in a slightly different fashion; state administrative procedure laws that require pension boards, like other governmental and quasi-governmental entities, to promulgate and adhere to sound procedural regulations; and state codes of ethics or conflict of interest laws that prohibit both the trustees and the employees of state boards and commissions from engaging in self-dealing.

In short, the context in which state pension plans operate is totally different from that in which private plans operate. Not only are all the records and proceedings of public plans open to the public, but they are required by law to submit a variety of detailed reports divulging virtually all of the systems' operating characteristics to legislative and other oversight bodies (whose reports are also open to the public). There is virtually nothing that an interested party cannot learn about the operations of a state pension plan. This same principle applies to funding methods. State and local pension plans are backed by the government, which is a permanent institution that has a strong moral, contractual, and, in some cases, constitutional commitment to back its pension liabilities.

The states' fiduciary duty standards deserve special mention. These standards are designed to protect the participants by insuring proper investment of the fund's assets While not all state statutes in the early 1980's mirrored the ERISA model of fiduciary duty, 45 states now have standards tha are either identical or similar to that standard (see NCTR's 19 survey entitled Fiduciary Duties Applicable to Public Retiremen Systems).[6] The other five states have strong self-dealing laws that punish fiduciaries for illegal activities. The high rate states using ERISA or ERISA-like standards strongly suggests th a duplicative federal fiduciary standard (and a federal cause o action) is unnecessary.

The federal cause of action won't increase the amount of money available for pension benefits. The legislative proposals offered to date do not include any federal financial commitments. They offer only regulatory interference. Regulation of the public funds should take place at the state level where retirees, employees, and taxpayers have meaningful input about how the pension funds should be operated. Thomas Jefferson said it best when he commented: "Were we directed fr Washington when to sow and when to reap, we should soon want fo bread." This lesson applies here as the federal government ca only muddle a system that already works. The long success of t

[6] NCTR is providing copies of both its studies to the Committee for its record of this hearing.

funds is due to the states and the states should continue their role in overseeing them.

One final note: there are serious concerns as to whether the federal government is competent to regulate state and local pension funds. The House Ways and Means Oversight Subcommittee issued a report recently showing that the books of the Pension Benefit Guaranty Corporation are in such disorder that they cannot be audited.[7] Questions have also arisen about the vigilance of the Department of Labor in light of the Executive Life Insurance Corporation default, which has jeopardized the future benefits of many private sector retirees. These developments suggest that a federal "rescue" of the public pension systems is a chimera.

In sum, the current problems between the states and their pension funds do not justify federal intervention. State law provides broad safeguards to protect the funds and the benefits of retirees. The political process also ensures that state, not federal officials, will be more responsive to state employee and retiree concerns. Under the concept of federalism, Congress should not interfere with traditional functions of state and local government, including employee compensation, of which pension benefits are a part. Uncle Sam is not providing any benefits, like federal funding guarantees, to accompany the

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[7] Report of the Subcommittee of Oversight on the Pension Benefit Guaranty Corporation's Program to Identify, Collect, and Account for Premium Payments, Committee on Ways and Means, U.S. House of Representatives, November 7, 1991

proposed burdens. Finally, the federal government's competence to regulate public plans is open to debate given its current record of regulating private funds.

For further information, contact Sarah Reilly or Cindie Moore, NCTR Washington Counsel, at 202-429-8122.

PUBLIC PENSION PLANS: THE STATE REGULATORY FRAMEWORK

NATIONAL COUNCIL
ON TEACHER RETIREMENT

September, 1985

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PUBLIC PENSION PLANS: THE STATE REGULATORY FRAMEWORK

This report, prepared by the National Council on Teacher Retirement (NCTR),[1] presents the results of a 50-state survey of the laws defining the reporting, disclosure and investment standards that govern public employee retirement systems. In addition to reviewing these laws, the report describes the legislative and executive oversight of public retirement systems mandated by state law.

The data for the report was collected by questionnaires sent to state plan administrators. The questionnaire results were supplemented by legal research to identify or verify state code citations and by follow-up telephone calls to clarify local practices.

Although the organizational focus of NCTR, the report's sponsor, is on teacher retirement systems, the research and resultant conclusions are relevant to state employee retirement systems generally. Roughly 24 of the states surveyed have a single consolidated retirement system for all state employees. And, in the remaining 26 states, where teachers and education personnel have separate retirement systems, the standard defining the reporting, disclosure and investment standards for these systems are essentially the same as the standards that apply to other state employee retirement systems. In 22 states (some with consolidated plans, others not), a single agency has been designated to perform the investment function for all retirement systems.

To put the conclusions of the report in context, it is necessary to look first at the general condition of state retirement systems. It is undisputed that these systems generally perform at a higher level than do their private or federal government counterparts. More public employees participate in retirement plans than do private employees (90% as compared to approximately 74% of the ERISA-relevant work force). State retirement systems offer more diverse benefits and higher benefit levels than do private plans. And, recent U.S. Census analyses show that public plans are better funded than either private pension plans or federal retirement plans. Over the past five years, public plans "have increased their assets and strengthened their funding . . . even though the beneficiary population has risen sharply."[2] Finally, state administered pension plans, which include roughly 90% of all covered public employees, are well managed and no state plan has ever defaulted in pension payments.

The only real problem in the state pension fund community, and one that afflicts a small percentage of that community, is underfunding. The seriousness of this problem is questionable, since many of the states guarantee their pension funds[3] and the remainder, although not guarantors in law, are politically bound to stand behind their retirants. In addition, the experts disagree as to proper funding levels for public plans, as compared with private plans. In any event, where state retirement systems are underfunded, that fact has been fully disclosed to the members and the public at large and is generally the subject of intense policy debate.

One reason for the sound health of state pension systems has been the extraordinary level of state legislative activity reforming public plan administration and oversight. As this report demonstrates, more than 23 states have special legislative retirement commissions charged with ongoing review of the performance of public pension systems and with making recommendations for needed legislative reforms (Chart A). These commissions have been responsible for major legislative initiatives in states such as Arkansas, Illinois and Pennsylvania. States lacking formal oversight commissions have designated permanent and interim committees of the legislature to oversee pension fund performance. These developments have resulted in a core group of state legislators and staff with special expertise on the complicated issues affecting public pension system administration.

Financial and System Performance Reporting: All state retirement systems are subject to independent audit and actuarial valuation. All state level systems are required by law to have an annual audit performed by either the state auditor or an independent auditor — or by both. All of the states have actuarial valuations performed by certified actuaries at least every two years (Massachusetts — three years) and the majority also commission periodic (3-5 years) valuations of the mortality, service and compensation experience of members and beneficiaries. These reports, which, for the most part, are prepared by major national firms with pension fund expertise, are distributed to key officers of the executive and the legislature, and are available to the public upon request. They are generally distributed to employers and members in summary form.

In addition to these outside assessments, all state retirement systems are required to file detailed financial reports with the Governor (the Commissioner of Insurance or some other members of the executive) and the legislature, some on a monthly and some on an annual basis. These reports, although differing in form from

[1] NCTR is a membership organization of 45 state, 13 local and two territorial retirement systems, some of which serve teachers exclusively, others of which include other state and local employee groups. The total assets of NCTR's 45 state systems are roughly $160 billion and the plans include over five million active participants.

[2] From EBRI (Employee Benefit Research Institute) News Release "New Five-Year Census Shows Fewer but Better-Funded State and Local Pension Systems." See also "1982 Census of Governments: Employee Retirement Systems of State and Local Governments" (GC82(6)-1).

[3] A 1983 survey by the National Education Association, entitled Retirement Systems of School Employees, identified 14 states that guarantee their retirement systems. This report identifies four additional states with similar guarantees: Florida, Maryland, Oklahoma, and South Dakota.

state to state,[4] provide comprehensive information on the financial performance and problems of the system. For the most part, the state officials who supervise the public plans receive more detailed information regarding plan operations than the U.S. Department of Labor currently receives regarding ERISA-regulated private pension plans.

If a legislator or a member of the public wants to go behind the formal retirement system reports, he is entitled in all 50 states to inspect the underlying transactional records of the system and/or to attend the meetings of its board. As Chart B demonstrates, all 50 states have enacted liberal government-in-the sunshine, Freedom of Information and open meetings laws. The net result is that all records and proceedings of the system are open except for individual retirant accounts and investment deliberations. Even in the investment area, as is discussed below, most of the state retirement systems have published investment policies and rely on outside investment performance analysts, whose reports are also available to the public.

Communication with Members: The NCTR survey found that the state retirement systems are particularly effective in the area of member outreach. Virtually all state systems distribute member handbooks outlining benefit options and summarizing the structure of the plan. The handbooks are supplemented by newsletters and brochures reporting on new developments as well as by individual and group consultations on retirement options led by field staff. In addition, many systems furnish separate pamphlets publishing the sections of the state code governing the performance of the retirement system (the codes are also available in most state libraries). Members in all 50 states are given annual written statements of the status of their individual accounts and are accorded formal appeal rights from the denial of benefits. Almost without exception, the retirement systems have made an effort to communicate in a clear and simple fashion with their members.

The New York and Delaware systems offer good examples of member outreach. NYSTRS conducts individual consultations for members at 26 locations throughout the state. During the 1983-84 school year, more than 6,000 members met with retirement system representatives and another 3,000 visited the plan's Albany offices. The system also conducted 75 group workshops and seminars, and published a quarterly newsletter for its participants. In Delaware, the system's 22 field officers traveled throughout the state to conduct group and individual counseling. The system additionally distributed various pamphlets and installed a toll-free "800" number for telephone inquiries.

Regulation of the Investment Function: Because the states bear ultimate responsibility (whether legal or political) for the viability of their retirement systems, investment performance has increasingly been the subject of legislative attention. Many states have enacted reforms to insure the actuarial soundness of their systems; others have simply strengthened the fiduciary standards governing those responsible for the investment function.

In this regard, the NCTR survey shows that 11 states have enacted a prudent expert rule similar to the ERISA rule (Alaska, Arkansas, California, Illinois, Kentucky, Louisiana, Massachusetts, Michigan, Ohio, Utah, and Wisconsin). Thirty-tree states have adopted the slightly more lenient prudent man rule (the level of prudence is that of one investing his own assets rather than that of an expert in institutional investment), which is generally combined with other guidelines such as a list of permissible investments, a mandate to diversify investments, limits on the level of investment permitted for any individual investment or category of investments, or a prohibition against one or more specific types of investment. Seven states have neither standard, relying instead on a stricter statutory definition of permissible investments (Delaware, Georgia, Hawaii, New Hampshire, New York, North Carolina and North Dakota) Three of these states (New York, New Hampshire, and Hawaii) have hybrid systems, consisting of specific statutory instructions for the bulk of investments, with greater flexibility allowed for a smaller percentage of investments (5, 10 or 15%) in regard to which the prudent person rule controls. (See Chart C for a summary of state investment standards.)

Almost all of the states have additional provisions directing that investments be made "in the best interests of the participants" or "for the exclusive purpose of providing benefits to participants and their beneficiaries." They also have ethics in government laws, conflict of interest laws or laws defining the responsibilities of trustees that proscribe self-dealing and profiteering and that hold public servants (such as the trustees and employees of retirement systems) to high ethical standards. The standards governing investments are backed by strict statutory sanctions for non-conformance, as are the ethics laws. In most states, violators may be punished by both civil and criminal penalties.

Equally important, the states are increasingly professionalizing the management of public retirement system assets and subjecting it to a high level of supervision. The NCTR survey showed that 45 state systems currently rely on outside investment performance analysts to assist them and the officers of the state in measuring fund performance. Forty-five states publish their investment policies, making them available to all interested parties. And all of the states are increasingly competitive in hiring outside investment managers and advisors. (See Chart D.) Equally important, through a variety of vehicles, the states are involving financial experts in the investment decision-making process. As noted above, over 22 states have separated the investment function from the benefit administration function, assigning the former to a state investment board responsible for investing all public pension system assets (and in some cases all state agency assets); other states have created special investment advisory committees drawing upon

[4] There is, however, increasing standardization in reporting because most of the state systems rely on a small number of leading actuarial firms. In addition, the trend toward standardization in financial reporting has received significant impetus from the recent activation of the Governmental Accounting Standards Board (GASB).

experts in the field who guide board members in making investment decisions; still other states have mandated the inclusion of investment experts on the board of trustees itself.

State employee retirement systems can undoubtedly be improved. But the NCTR survey makes it clear that, for the most part, the 90% of all state and local employees covered by these systems are well served. Over the past 5-10 years, the state legislatures have enacted and continue to enact major legislative reforms that have resulted in administrative improvements for these systems that put them ahead of their private and federal government counterparts. In recent years, many state legislatures have also begun to attack the problems of local government pension systems, imposing consolidation schemes, uniform reporting requirements and other much needed reforms. Some have even offered emergency financial guarantees to local systems. As the U.S. Advisory Commission on Intergovernmental Relations (ACIR) has reported: "state and local governments have established a record as permanent, economically secure institutions with strong moral, contractural, and, in some cases, constitutional commitments backing pension liabilities."[5]

In summary, the state regulatory frameworks governing state retirement systems are well conceived and, for the most part, well enforced. They are reviewed periodically and systematically by the state legislatures. The necessary laws are on the books to protect plan participants and beneficiaries. It's up to state government officials, retirement system administrators, system members and the concerned public to make certain that they are effectively implemented.

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[5] Advisory Commission on Intergovernmental Relations, "State and Local Pension Systems," Washington, D.C., December, 1980 (A-71).

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CHART A
LEGISLATIVE OVERSIGHT COMMISSIONS OR COMMITTEES

ALABAMA (TRSA)	House Ways & Means Committee Senate Finance & Taxation Committee
ALASKA (ATRS)	Health, Education & Social Services Committee Finance Committee
ARIZONA (ASRS)	House Government Operations Committee Senate Insurance, Retirement & Aging Committee Joint Legislative Budget Committee
ARKANSAS (ATRS)	• State Pension Review Board Joint Legislative Committee on Public Retirement and Social Security Programs
CALIFORNIA (STRSC)	• Joint Committee on Public Pension Fund Investments
COLORADO (PERA)	Legislative Audit Committee
CONNECTICUT (CTRS)	Appropriations Committee
DELAWARE (DSEPP)	State Department of Finance *
FLORIDA (FRS)	House Committee on Retirement, Personnel & Collective Bargaining Senate Committee on Personnel, Retirement & Collective Bargaining
GEORGIA (TRSG)	House Retirement Committee Senate Retirement Committee
HAWAII (HERS)	Public Employment and Government Operations Committee
IDAHO (PERSI)	State Affairs Committee (both houses)
ILLINOIS (ITRS)	Pension Laws Committee (both houses) • Illinois Economic and Fiscal Commission
INDIANA (ISTRF)	• Pension Management Oversight Commission

* Primary supervision is performed by this Department.

• Indicates special committee or commission charged with oversight of public pension system performance, including assessment of proposed legislation affecting public system.

IOWA (IPERS)	• Joint State Government Committee
KANSAS (KPERS)	House and Senate Ways & Means Committees House Pensions, Investments & Benefits Committee
KENTUCKY (TRSKY)	House and Senate Appropriations and Revenue Committees and Education Committee
LOUISIANA (TRSL)	• Joint Legislative Retirement Committee
MAINE (MSRS)	Joint Standing Committee on Aging, Veterans and Retirement
MARYLAND (MSRPS)	• Annual *ad hoc* Joint Pension Committee
MASSACHUSETTS (MTRS)	Committee on Public Service
MICHIGAN (MPSERS)	House Retirement Committee Senate Appropriations Subcommittee on Retirement
MINNESOTA (MTRA)	• Legislative Commission on Pensions & Retirement
MISSISSIPPI (PERS)	House Appropriations Committee Senate Finance Committee
MISSOURI (PSRSM)	• Joint Committee on Public Employee Retirement
MONTANA (MTRS)	Legislative Council
NEBRASKA (NSERS)	• Legislative Retirement Committee
NEVADA (PERSON)	• Interim Retirement Committee
NEW HAMPSHIRE (NHRS)	House/Senate Appropriations Committees
NEW JERSEY (TPAF-NJ)	Mostly *ad hoc* but especially Government & Civil Service, Pensions, & Veterans' Affairs Committee

NEW MEXICO (NMERS)	Legislative Finance Committee
NEW YORK (NYSTRS)	Senate: Civil Service & Pensions Committee Finance Committee House: Government Employees Committee Ways & Means Committee
NORTH CAROLINA (TPERS)	• Senate Pensions & Retirement Committee
NORTH DAKOTA (TFFR)	Legislative Audit Committee Legislative Budget Committee Legislative Committee on Public Retirement
OHIO (STRSO)	• Retirement Study Commission
OKLAHOMA (TRSO)	Senate Committee on Judiciary & Retirement House Committee on Retirement Laws
OREGON (OPERS)	Retirement, Banking & Insurance Committee
PENNSYLVANIA (PPSERS)	• Public Employee Retirement Study Committee
RHODE ISLAND (ERSRI)	• Joint Committee on Pensions & Retirement
SOUTH CAROLINA (SCRS)	• Joint Continuing Committee on Retirement
SOUTH DAKOTA (SDRS)	Retirement Laws Committee
TENNESSEE (TCRS)	• Council on Pensions & Retirement
TEXAS (TRST)	• State Pension Review Board
UTAH (USRB)	Retirement Subcommittee (of State & Local Affairs Committee) Joint Appropriations Committee on General Government & Capital Facilities (budget)
VERMONT (TRSV)	House & Senate Government Operations Committees and Appropriations Committees

VIRGINIA (VSRS)	• Retirement System Review Board
WASHINGTON (WDRS)	House/Senate Ways & Means Committees
WEST VIRGINIA (STRS)	• Joint Commission on Pensions & Retirement
WISCONSIN (WRS)	• Joint Survey Committee on Retirement Systems Retirement Research Committee
WYOMING (WRS)	Joint Appropriations Committee
CITY SYSTEMS	
CHICAGO (CTPF)	• Public Employee Pension Laws Commission
MINNEAPOLIS (MTRFA)	• State Legislative Committee on Pensions & Retirement
ST. LOUIS (PSRS)	Joint Committee on Public Employee Retirement

CHART B
OPEN RECORDS AND OPEN MEETINGS LAWS

ALABAMA (TRSA)	Public Records Law - ALA. CODE tit. 36, § 12-40 Open Board Meetings - ALA. CODE tit. 13A, § 14-2(a)
ALASKA (ATRS)	Public Records Law - ALASKA STAT. § 09.25.110 Open Board Meetings - ALASKA STAT. § 44.62.310
ARIZONA (ASRS)	Public Records Law - ARIZ. REV. STAT. ANN. § 39-121 Open Board Meetings - ARIZ. REV. STAT. ANN. § 38-431
ARKANSAS (ATRS)	Open Board Meetings - ARK. STAT. ANN. § 12-2801 and § 80-1438.3.05 FOIA - ARK. STAT. ANN. § 12-2803
CALIFORNIA (STRSC)	Public Records Law - CAL. EDUC. CODE § 22221 (DEERING) Open Board Meetings - CAL. GOV'T CODE § 6250 (DEERING)
COLORADO (PERA)	Public Records Law - COLO. REV. STAT. § 24-72-203 Open Board Meetings - COLO. REV. STAT. § 24-6-402
CONNECTICUT (CTRS)	Public Records Law - CONN. GEN. STAT. § 1-19 Open Board Meetings - CONN. GEN. STAT. § 1-21
DELAWARE (DSEPP)	Public Records Law - DEL. CODE ANN. tit. 29, § 10002 Open Board Meetings - DEL. CODE ANN. tit. 29, § 10004(a)
FLORIDA (FRS)	Public Records Law - FLA. STAT. § 119.07 Open Board and Commission Meetings - FLA. STAT. § 286.011
GEORGIA (TRSG)	Public Records Law - GA. CODE § 47-3-26(f) Open Board Meetings - GA. CODE § 47-3-26(f)
HAWAII (HERS)	FOIA - HAWAII REV. STAT. §§ 88-103,92-50 Open Board Meetings - HAWAII REV. STAT. § 92-2
IDAHO (PERSI)	FOIA - IDAHO CODE § 9.301 Open Board Meetings - IDAHO CODE § 67-2341
ILLINOIS (ITRS)	Public Records Law - ILL. REV. STAT. ch. 108-1/2, § 16-174; ch. 116, § 43.6 Open Board Meetings - ILL. REV. STAT. ch. 102, § 41.42
INDIANA (ISTRF)	Public Records Law - IND. CODE § 5-14-1-3 Open Board Meetings - IND. CODE § 5-14-1-4
IOWA (IPERS)	Public Records Law - IOWA CODE § 28A.3 Open Board Meetings - IOWA CODE § 28A.2

KANSAS (KPERS)	Public Records Law - KAN. STAT. ANN. § 45-201 and § 74-4909(2) Open Board Meetings - KAN. STAT. ANN. § 74-4909(4)
KENTUCKY (TRSKY)	FOIA - KY. REV. STAT. § 61.872 FOIA - Teachers - KY. REV. STAT. § 61.884 Open Board Meetings - KY. REV. STAT. § 61.805
LOUISIANA (TRSL)	Public Records Law - LA. REV. STAT. § 17:657 & § 1 *et seq.* Open Board Meetings - LA. REV. STAT. § 42:5
MAINE (MSRS)	Public Records Law - ME. REV. STAT. ANN. tit. 1, § 402; tit. 5, § 1031.9 Open Board Meetings - ME. REV. STAT. ANN. tit. 1, § 404
MARYLAND (MSRPS)	FOIA - MD. STATE GOV'T CODE ANN. § 10-612 Open Board Meetings - MD. STATE GOV'T CODE ANN. § 10-505
MASSACHUSETTS (MTRS)	Public Records Law - MASS. GEN. LAWS ANN. ch. 66, § 10 (WEST) Open Board Meetings - MASS. GEN. LAWS ANN. ch. 30A, § 11A-1/2 (WEST)
MICHIGAN (MPSERS)	Public Records Law - MICH. STAT. ANN. § 4.1801(1) Open Board Meetings - MICH. STAT. ANN. § 38.1323
MINNESOTA (MTRA)	FOIA - MINN. STAT. ANN. § 15.1672 (WEST) Open Board Meetings - MINN. STAT. ANN. § 471.705 (WEST)
MISSISSIPPI (PERS)	Public Records Law - MISS. CODE ANN. §§ 25-11-119(2), 25-61-1 Open Board Meetings - MISS. CODE ANN. §§ 25-11-119(4), 25-41-3
MISSOURI (PSRSM)	Public Records Law - MO. ANN. STAT. §§ 109.180, 169.020, 610.105 (VERNON) Open Board Meetings - MO. ANN. STAT. §§ 109.180, 169.020, 610.105 (VERNON)
MONTANA (MTRS)	Public Records Law - MONT. CODE ANN. §§ 19-4-201(3), 2-3-212, 93-10001-3 Open Board Meetings - MONT. CODE ANN. § 2-3-203
NEBRASKA (NSERS)	Public Records Law - NEB. REV. STAT. § 84-712 Open Board Meetings - NEB. REV. STAT. § 84-1409
NEVADA (PERSON)	FOIA - NEV. REV. STAT. § 239.010 Open Board Meetings - NEV. REV. STAT. § 241.020
NEW HAMPSHIRE (NHRS)	Public Records Law - N.H. REV. STAT. ANN. § 91-A:4 Open Board Meetings - N.H. REV. STAT. ANN. § 91-A:1-a
NEW JERSEY (TPAF-NJ)	Public Records Law - N.J. STAT. ANN. § 41:1A-2 (WEST) Open Board Meetings - N.J. STAT. ANN. § 10:4-12a (WEST)
NEW MEXICO (NMERS)	FOIA - N.M. STAT. ANN. § 14-2-1 Open Board Meetings - N.M. STAT. ANN. § 10-15-1

NEW YORK (NYSTRS)	FOIA - N.Y. PUB. OFF. LAW § 85; N.Y. EDUC. LAW § 508(6) Open Board Meetings - N.Y. PUB. OFF. LAW § 97
NORTH CAROLINA (TPERS)	Public Records Law - N.C. GEN. STAT. § 132-1 Open Board Meetings - N.C. GEN. STAT. § 143-318.10
NORTH DAKOTA (TFFR)	Public Records Law - N.D. CENT. CODE § 44-04-18 Open Board Meetings - N.D. CENT. CODE § 40-04-19; N.D. CONST. AMEND. Art. 92
OHIO (STRSO)	Public Records Law - OHIO REV. CODE ANN. § 3307.21 Open Board Meetings - OHIO REV. CODE ANN. § 121.22B
OKLAHOMA (TRSO)	Public Records Law - OKLA. STAT. tit. 51, § 51-24 Open Board Meetings - OKLA. STAT. tit. 51, § 25-304
OREGON (OPERS)	Public Records Law - OR. REV. STAT. § 192.420 Open Board Meetings - OR. REV. STAT. § 192.610
PENNSYLVANIA (PPSRS)	Public Records Law - 24 PA. CONS. STAT. ANN. § 8502(d) and (e) Open Board Meetings - 65 PA. CONS. STAT. ANN. § 267
RHODE ISLAND (ERSRI)	FOIA - R.I. GEN. LAWS § 38-2-2 Open Board Meetings - R.I. GEN. LAWS § 42-46-2
SOUTH CAROLINA (SCRS)	Public Records Law - S.C. CODE § 9-1-300 FOIA - S.C. CODE §§ 3 and 6
SOUTH DAKOTA (SDRS)	Public Records Law - S.D. CODIFIED LAWS ANN. § 3-12-59 Open Board Meetings - S.D. CODIFIED LAWS ANN. §§ 1-25-1 and 1-25-2
TENNESSEE (TCRS)	Public Records Law - TENN. CODE ANN. § 8-34-315 (Proceedings of Bd.); TENN. CODE ANN. § 10-78-104 (state) Open Board Meetings - TENN. CODE ANN. § 8-4402
TEXAS (TRST)	Public Records Law - TEX. REV. CIV. STAT. ANN. art. 6252-17a and art. 1108, § 35.107 (VERNON) Open Board Meetings - TEX. REV. CIV. STAT. ANN. art. 6252-17
UTAH (USRB)	Public Records Law - UTAH CODE ANN. §§ 52-4-2 Open Board Meetings - UTAH CODE ANN. § 78-26-1
VERMONT (TRSV)	Public Records Law - VT. STAT. ANN. tit. 16, § 1942; tit. 1, § 317 Open Board Meetings - VT. STAT. ANN. tit. 1, § 312
VIRGINIA (VSRS)	FOIA - VA. CODE § 2.1-341,342 Open Board Meetings - VA. CODE § 15-111.23

WASHINGTON (WDRS)	Public Records Law - WASH. REV. CODE § 42.17.260 Open Board Meetings - WASH. REV. CODE § 42.30.020
WEST VIRGINIA (STRS)	Public Records Law - W.VA. CODE § 1; § 6-9A-2 Open Board Meetings - W.VA. CODE § 29B-1-2
WISCONSIN (WRS)	FOIA - WIS. STAT. § 19.35 Open Board Meetings - WIS. STAT. § 19.83
WYOMING (WRS)	Public Records Law - WYO. STAT. § 9-9-101 Open Board Meetings - WYO. STAT. § 9-11-102
CITY SYSTEMS	
CHICAGO (CTPF)	Public Records Law - ILL. REV. STAT. ch. 116, § 43.6 Open Board Meetings - ILL. REV. STAT. ch. 102, §§ 41 and 42
ST. LOUIS (PSRS)	Public Records Law - MO. REV. STAT. § 169.450.10 Open Board Meetings - MO. REV. STAT. § 610.010
MINNEAPOLIS (MTRFA)	None.

CHART C
FIDUCIARY STANDARDS GOVERNING INVESTMENTS

ALABAMA (TRSA)	prudent person (as part of investment policy); can make same investments as domestic life insurance companies (tit. 16, § 25-20); 20% limit on equities
ALASKA (ATRS)	ERISA prudent expert (§ 14.25.180(c)); statutory list of permissible investments (§ 14.25.180)
ARIZONA (ASRS)	prudent person (§ 14-7302); statutory list of permissible investments (§ 38.757)
ARKANSAS (ATRS)	ERISA prudent expert (§ 12-3307.7.01); Arkansas-related investments 5-10% (§ 12-3307.7.14)
CALIFORNIA (STRSC)	prudent expert (Cal. Const. Sec. 17, Art. XVI); statutory list of permissible investments (EDUC. CODE § 22222); must diversify; 25% must go to Cal. residential mortgages (FIN. CODE § 13000)
COLORADO (PERA)	prudent person (§ 15-1-304) - 50% limit corp. stock/convertible debentures
CONNECTICUT (CTRS)	same standard as applies to savings banks and trust funds — prudent investor (§ 10-183m); statutory limits (§ 3-13d, § 36-94); encourages diversification; 50% limit on common stock
DELAWARE (DSEPP)	prudent person (board policy); no other limits
FLORIDA (FRS)	prudent person; diversification (§§ 215.47(7) and 581.11); statutory limits on permissible investments and statutory definition of manner in which benefits must be related to funding (§§ 21, 112; Art. X, Section 14 Constitution)
GEORGIA (TRSG)	subject to restrictions imposed on domestic life insurers and provided no more than 50% of system's assets are invested in equities; statutory limits on level of any single investment. (Investment policy assumes prudent person standard.)
HAWAII (HERS)	statutory list of permissible investments; 40% limit on common and preferred stocks; 10% of book value may be invested according to "prudent person" standard (§ 88-119)
IDAHO (PERSI)	prudent person (§ 68-502); Board sets investment policy
ILLINOIS (ITRS)	prudent expert (ch. 108-1/2, § 1-109-1): diversification
INDIANA (ISTRF)	prudent person (§ 21-6.1-3-9); statutory list of permissible investments; no investments in equities (Art. II, § 12 Constitution)

IOWA (IPERS)	prudent person (§ 97B.7.b), with statutory restrictions on permissible investments
KANSAS (KPERS)	prudent person (§ 74-4921) - 50% limit on common stock
KENTUCKY (TRSKY)	ERISA prudent expert (§ 161.430); prohibition against buying more than 25% of any single stock issue and against investing more than 7% of system's invested funds in any issue.
LOUISIANA (TRSL)	prudent expert (§ 42:715-717) - 25% limit on investments in equities
MAINE (MSRS)	prudent person (tit. 5, § 1061.1)
MARYLAND (MSRPS)	prudent person (art. 73B, § 74) - 50% limit on purchases of common stock; no more than 15% in non-dividend stock
MASSACHUSETTS (MTRS)	prudent expert (ch. 32, § 23(3)); statutory restrictions (ch. 32, § 23(2A)(h)); no mortgages or collateral loans; about 1% of fund must go to Mass. Technology Develop. Corp.; no investments in South Africa or N. Ireland munitions manufacturers
MICHIGAN (MPSERS)	prudent expert (§ 38.1132); statutory list of permissible investments (§ 38.1132) and 50% limit on corp. equities; 2% limit on venture capital
MINNESOTA (MTRA)	prudent person (§ 11A.01); statutory limits — 80% of assets must be invested in government obligations, qualified corporate obligations and other types of commercial paper, and mortgage participation certificates; 20% may be allocated to more speculative investments
MISSISSIPPI (PERS)	prudent person (§ 25-11-121); statutory list of permissible investments (§ 25-11-121(1-5))
MISSOURI (PSRSM)	prudent person (§ 169.040.2); statutory list of permissible investments (§ 169.040) - must diversify
MONTANA (MTRS)	prudent person (§ 17-6-201); statutory list of permissible investments (§ 17-6-211), with limits set by category
NEBRASKA (NSERS)	prudent person (§ 72 1247); no buying on margin; no put or call options
NEVADA (PERSON)	prudent person (§ 286.682); no investments in South Africa unless companies conform to Sullivan principles

NEW HAMPSHIRE (NHRS)	statutory list of permissible investments, which are those authorized for domestic life insurance companies (§ 100-A:15); 15% of assets may be invested more freely according to prudent person standard. Board is also directed to invest in manner that will benefit state's economy, so long as consistent with sound investment practices.
NEW JERSEY (TPAF-NJ)	prudent person (§ 3B:20-12); statutory list of permissible investments, with limits on investments in common stock
NEW MEXICO (NMERS)	prudent person (§ 22-11-13(c)); statutory limits imposed on categories of investments (§ 22-11-13) (75% limit corp stocks/bonds)
NEW YORK (NYSTRS)	95% according to statutory list of permissible investments; 5% according to prudent person standard (EDUC. LAW § 508)
NORTH CAROLINA (TPERS)	statutory list of permissible investments
NORTH DAKOTA (TFFR)	"best interests" of state (§ 21-10-05); statutory list of permissible investments (§ 26-10-07), with 80% fixed income mandatory and 30% limit on equities
OHIO (STRSO)	prudent expert; statutory investments (§ 3307.15), with specified limits (35% limit on equities, 25% limit on real estate, 5% limit on venture capital)
OKLAHOMA (TRSO)	prudent person (tit. 70, § 17-107(a)); statutory list of permissible investments (tit. 70, § 17-107(B))
OREGON (OPERS)	prudent person (§ 293.726); 50% limit on investments in common stocks
PENNSYLVANIA (PPSERS)	prudent person re corporate stock (ch. 24 § 8521(h)), with limits on level of investment in any one company
RHODE ISLAND (ERSRI)	prudent person (§ 35-10-6)
SOUTH CAROLINA (SCRS)	prudent person (§ 21-11-10); statutory list of permissible investments (§ 11-9-660)
SOUTH DAKOTA (SDRS)	prudent person (§ 4-5-27); State Investment Council required to formulate policy (§ 4-5-28)
TENNESSEE (TCRS)	prudent person (§ 35-3-117(b)); same standards as apply to domestic life insurers, with 50% limit on stocks (§ 56-3-303)
TEXAS (TRST)	prudent person (art. 16, § 67); no equity ownership in real estate
UTAH (USRB)	ERISA prudent expert (§ 49-9-12); broad authorization

VERMONT (TRSV)	prudent person (tit. 8; § 3643); statutory list of permissible investments (tit. 16; § 1943)
VIRGINIA (VSRS)	prudent person (§ 51-111.24:2); statutory list of permissible investments (§ 51-111.24)
WASHINGTON (WDRS)	prudent person (§§ 41.50.085, 43.33A.14) plus diversification; certain limits on individual investments
WEST VIRGINIA (STRS)	prudent person (§ 12-6-12); statutory list of permissible investments (§ 12-6-8(f)); no equities; 75% limit on corporate debt, 20% cap on corporate debt maturing in one year, and 3% ceiling on debt in single corporation
WISCONSIN (WRS)	ERISA prudent expert (1983 Budget Act); board has same authority as insurance companies in regard to fixed dividend investments, and may invest 50% of assets in other categories.
WYOMING (WRS)	prudent person (§ 2-3-301); statutory list of permissible investments (§ 9-3-424) - 35% limit corp. stock, with no more than 1% in any one corporation.
CITY SYSTEMS	
CHICAGO (CTPF)	ERISA prudent expert (ch. 108-1/2, § 1-109(b)); statutory list of permissible investments (ch. 108-1/2, § 1-113)
MINNEAPOLIS (MTRFA)	prudent person; no capital stock
ST. LOUIS (PSRS)	prudent person (§ 169.480)

CHART D
STATE RETIREMENT SYSTEM INVESTMENT ADMINISTRATION

	Reliance on Outside Investment Performance Analyst	Responsibility for Investments	Published Investment Policy
ALABAMA (TRSA)	No	Board of Trustees, assisted by 7-person in-house staff plus AmSouth Bank	Yes
ALASKA (ATRS)	Merrill Lynch	Commissioner of Revenue, assisted by 4 in-house staff plus 13 outside advisors	Yes
ARIZONA (ASRS)	SEI Funds Evaluation Services Wilshire Associates	Investment Advisory Council (5 members with 10 years' investment experience), assisted by outside investment managers (8 firms)	No
ARKANSAS (ATRS)	No	Investment Committee of Board of Trustees, assisted by Oppenheimer Capital and First Commercial Bank of Little Rock	Yes
CALIFORNIA (STRSC)	Wilshire Associates	Board of Trustees, assisted by Wilshire Associates (2 Board members must have investment experience)	Yes
COLORADO (PERA)	Merrill Lynch	Board of Trustees assisted by 7-member investment staff. Also, Bankers Trust Co. of N.Y. and Provident National Bank of Philadelphia	Yes
CONNECTICUT (CTRS)	State Auditor of Public Accounts	State Treasurer assisted by Investment Advisory Council (including 5 outside experts)	Yes
DELAWARE (DSEPP)	Gentry Associates	Board of Trustees assisted by 20 money management firms and Ashford Capital Management	Yes
FLORIDA (FRS)	SEI Funds Evaluation Services	State Board of Administration assisted by 6-person Investment Advisory Council	Yes
GEORGIA (TRSG)	Merrill Lynch	Investment Committee of Board of Trustees with guidance from First National Bank of Atlanta	Yes
HAWAII (HERS)	SEI Funds Evaluaton Services Callan Associates	Board of Trustees assisted by 16 money management firms (1 trustee must be an expert)	Yes

	Reliance on Outside Investment Performance Analyst	Responsibility for Investments	Published Investment Policy
IDAHO (PERSI)	SEI Funds Evaluation Services	Board of Trustees assisted by funding agents (bank, trust company, legal reserve life insurance company, etc.)	Yes
ILLINOIS (ITRS)	SEI Funds Evaluation Services	State Board of Investments assisted by 20 outside investment managers	Yes
INDIANA (ISTRF)	No	Board of Trustees assisted by staff investment manager and 5 outside advisors (5 trustees have financial experience; two are required by statute)	Yes
IOWA (IPERS)	Wilshire Associates	State Treasurer assisted by Advisory Investment Board (7 members, three of whom must be experts)	Yes
KANSAS (KPERS)	Callan Associates	Board of Trustees chosen for investment expertise, assisted by investment counselors (6)	Yes
KENTUCKY (TRSKY)	SEI Funds Evaluation Services Merrill Lynch	Board of Trustees assisted by 2 persons in-house and also by Todd Investment Advisors and Alliance Capital Management, Inc.	Yes
LOUISIANA (TRSL)	Merrill Lynch	Board of Trustees assisted by 4-member investment staff and outside counselors (4)	Yes
MAINE (MSRS)	Boston Company	Board of Trustees assisted by 13 outside investment managers (2 trustees are experts)	Yes
MARYLAND (MSRPS)	No	State Investment Agency (SIA) assisted by in-house staff as well as outside investment managers and advisors. SIA is supervised by State Investment Council (includes Board members from various public plans plus 3 experts)	Yes
MASSACHUSETTS (MTRS)	State Analyst	Pension Reserves Investment Management Board and the 3-member investment committee	Yes
MICHIGAN (MPSERS)	SEI Funds Evaluation Services	State Treasurer assisted by Investment Advisory Committee (5 members)	No

	Reliance on Outside Investment Performance Analyst	Responsibility for Investments	Published Investment Policy
MINNESOTA (MTRA)	Merrill Lynch	State Board of Investment assisted by Investment Advisory Council (trustees of state pension plans and 10 experts included) and 21 outside investment managers	Yes
MISSISSIPPI (PERS)	SEI Funds Evaluation Services	Board of Trustees assisted by in-house managers plus 12 outside investment managers (7 fixed, 5 equity)	Yes
MISSOURI (PSRSM)	National FSI Investment performance System	Board of Trustees assisted by Boatmen's Bank of St. Louis	Yes
MONTANA (MTRS)	Scudder, Stevens & Clark	State Board of Investments	No
NEBRASKA (NSERS)	No	State Investment Council assisted by in-house investment officer and Travelers Ins. Co. and Provident Investment Accounts	Yes
NEVADA (PERSON)	Shaw Data Services, Inc.	Board of Trustees assisted by private investment counselors (4)	Yes
NEW HAMPSHIRE (NHRS)	SEI Funds Evaluation Services	Board of Trustees assisted by 10 outside investment counselors	Yes
NEW JERSEY (TPAF-NJ)	SEI Funds Evaluation Services Merrill Lynch INDATA	State Investment Council (10 members - 5 with expertise)	Yes
NEW MEXICO (NMERS)	DeMarche & Associates	State Investment Council (a subcommittee of the Board of Trustees) assisted by private counselors (Von, Nelson, Scarborough & McConnell)	Yes
NEW YORK (NYSTRS)	Buck Pension Fund Services, Inc.	Board of Trustees (has 2 experts) assisted by Investment Advisory Committee and Mortgage Advisory Committee (both composed of outside experts) and 7 in-house investment staff	Yes

	Reliance on Outside Investment Performance Analyst	Responsibility for Investments	Published Investment Policy
NORTH CAROLINA (TPERS)	No	State Treasurer assisted by in-house staff and outside equity advisors. Also assisted by Equity Investment Advisory Committee	No
NORTH DAKOTA (TFFR)	Callan Associates	State Investment Board (5) assisted by Investment Director and outside managers (Bank of North Dakota and Robert & Sullivan)	Yes
OHIO (STRSO)	SEI Funds Evaluation Services	Board of Trustees assisted by 12 professionals in-house plus two outside advisors, Thorndike, Doran, Paine & Lewis and Karsten Companies	Yes
OKLAHOMA (TRSO)	SEI Funds Evaluation Services	Board of Trustees assisted by 3 in-house experts plus 3 outside counselors	Yes
OREGON (OPERS)	Wilshire Associates	State Treasurer assisted by Oregon Investment Council and 22 outside advisors	No
PENNSYLVANIA (PPSERS)	Evaluation Associates, Inc.	Board of Trustees assisted by 14 private sector managers	Yes
RHODE ISLAND (ERSRI)	Performed by banks represented by 3 expert SIC members	State Investment Commission (7 members, 3 banking experts)	Yes
SOUTH CAROLINA (SCRS)	A. G. Becker	Board of Trustees assisted by 5-person professional staff plus Jamieson, Eaton & Wood, Inc.	Yes
SOUTH DAKOTA (SDRS)	SEI Funds Evaluation Services	State Investment Council assisted by 6 outside managers	Yes
TENNESSEE (TCRS)	Council on Pensions & Retirement/Fiscal Review Committee in legislature	Board of Trustees assisted by Investment Advisory Council (5 experts, each with 5 years' experience)	Yes
TEXAS (TRST)	Merrill Lynch Thorndike, Doran, Paine & Lewis	Board of Trustees assisted by Investment Advisory Committee (13 private investment specialists)	Yes

	Reliance on Outside Investment Performance Analyst	Responsibility for Investments	Published Investment Policy
UTAH (USRB)	SEI Funds Evaluation Services	Board of Trustees assisted by professional in-house staff and 6 outside advisors	Yes
VERMONT (TRSV)	SEI Funds Evaluation Services	Board of Trustees assisted by Delaware Investment Advisors, Loomis Sayles, Rampart Investment Managers and Putnam Investment Advisors	Yes
VIRGINIA (VSRS)	Rogers, Casey & Barksdale	Board of Trustees assisted by Investment Advisory Council (3 experts) and 12 professional in-house staff plus 13-15 outside managers/advisors	Yes
WASHINGTON (WDRS)	Merrill Lynch	State Investment Board assisted by 5 outside advisors	Yes
WEST VIRGINIA (STRS)	Legislative Auditor	State Board of Investments assisted by Pittsburgh National Bank	Yes
WISCONSIN (WRS)	CDA Investment Technologies, Inc.	State Investment Board (including 2 WRS members and 4 experts)	Yes
WYOMING (WRS)	Segal Advisors, Inc.	Board of Trustees assisted by Alliance Capital Management Co., Lehman Management Co., Northwest Bank, N.A.	Yes
CITY SYSTEMS			
CHICAGO (CTPF)	Gabriel, Roeder, Smith & Co.	Board of Trustees assisted by Capital Supervisors, Inc.	No
MINNEAPOLIS (MTRFA)	First Corporate Securities of Minneapolis	Board of Trustees assisted by Advisory Investment Committee of experts	Yes
ST. LOUIS (PSRS)	DeMarche Associates	Board of Trustees assisted by outside managers (Mercantile Bank, Centerre Bank, Boatmen's Bank)	Yes

NATIONAL COUNCIL ON TEACHER RETIREMENT

FIDUCIARY DUTIES
APPLICABLE TO
PUBLIC RETIREMENT SYSTEMS

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Prepared by:

Sarah C. Reilly and
Cynthia L. Moore
STEPTOE & JOHNSON
1330 Connecticut Avenue, N.W.
Washinton, D.C. 20036

INTRODUCTION

This study was prepared at the request of the National Council on Teacher Retirement ("NCTR")[1/] to respond to "Fiduciary Responsibility Requirements of the Pension and Retirement Plans for State Employees" prepared by the Congressional Research Service of the Library of Congress ("1988 CRS Report"). Issued on August 8, 1988, the 1988 CRS Report failed to cover several significant areas of state law that regulate the conduct of public retirement system fiduciaries. Those areas included common law and statutory trust remedies, criminal laws, conflicts of interest laws, and ethics laws. Because of the authors' failure to consider the common law trust remedies and the other laws, they wrongly concluded that some states have no penalties whatsoever for pension system fiduciaries who breach their duties.

The 1988 CRS Report was requested by members of the House Education and Labor Committee who argue that states' regulation of public retirement systems' fiduciaries is inadequate. These proponents argue that federal fiduciary standards should supplant state law.

CRS issued a second report, "Public Pension Plans: The Issues Raised over Control of Plan Assets" on May 15, 1990 ("1990 CRS Report"). Unlike the first report, the 1990 CRS Report recognized that "all States have a strong body of common trust laws as well as statutory trust laws to protect the financial integrity of pension trust funds." (Page 50)[2/]

[1/] The NCTR is a membership organization of 50 state, 10 local, and one territorial retirement systems, some of which cover teachers exclusively, others of which cover other state and local employee groups.

[2/] A recent report by the General Accounting Office ("GAO") made a similar observation:

> The plans' [i.e., the four plans surveyed by the GAO] enabling statutes do not include provisions concerning penalties for violations of fiduciary responsibilities. But inappropriate actions could constitute violations under other statutes, plan officials said. Among them are laws concerning fraud, standards of conduct by trust fiduciaries in general,
> (continued...)

This study lays out the laws of each state that govern the conduct of public pension fiduciaries, including the significant areas that the authors of the 1988 CRS Report missed. It will assist federal policy makers in evaluating the extent of protection afforded to pension funds.

The study indicates a high degree of regulation among the states. Almost all states adhere to the prudent expert or prudent person fiduciary standard. All have criminal laws that apply to fiduciaries who breach their duties. Many have extensive codes of ethics or conflict of interest laws that regulate the activity of public officials and employees, including those involved in public pension systems. All states have either common law or statutory trust remedies, as noted by the 1990 CRS Report.

Also pointed out in the study are the checks and balances that exist in public plan regulation. A number of states list the types of investments in which system fiduciaries may invest. Other states restrict the amount of fund assets that may be made in any one type of investments. These requirements prevent fiduciaries from making risky investments.

In addition to the broad array of protections described in this study, states adhere to further practices that safeguard retirement system assets. For example, all states have legislative and/or executive oversight of the pension systems' assets. A number of states also regularly consult with outside investment performance analysts to assist in measuring fund performance.

In summary, state law governing pension fiduciaries is detailed and comprehensive. Remedies for breaching fiduciaries exist across the board. The existing framework provides great protection that safeguards the assets of public pension systems.

2/ (...continued)
and state employees' codes of conduct. Penalties under these statutes include removal from office, fines, and imprisonment.

"Public Plans in Four States Have Generally Similar Policies and Practices," GAO, July 1990.

The Myths of State Employee Pensions

How Cal-Tax is trying to preserve corporate loopholes by cutting state employee pensions

A paid publication of Californians For A Sound Future

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Myth:
State employees do not depend on their pensions.

Fact:
State employees count on their pensions just as private sector employees depend on theirs.

GRAYCE GAMES

Secretary, Department of Water Resources, from 1960–1966; Legal Stenographer, Cal-Trans, 1966–1978; Legal Support Supervisor, Department of Water Resources, 1978-1988

"For 30 years I worked for the State of California and I loved it. In fact, I would be still working for the state but my husband came down with A.L.S. (Lou Gehrig's disease). I had no choice but to quit my job and take care of my husband. My husband and I are counting on our pension and counting on it not to be eaten away by inflation. I stuck by the state for 30 years. I think the state should stick by its employees and treat them right."

MARTHA RHYMER

Legal Stenographer, Cal-Trans (Department of Public Works), from 1956–1972

"I know the state has a big deficit but everybody needs to pitch in to solve the problem. It shouldn't be just taken from state workers. I think that it is real lousy that these large corporations will not have to pay their fair share of taxes and then try to take away the state workers' pensions. The state, just like any company, had a duty to take care of employees. California's largest employer should have a pension plan that is safe and that people can count on. The budget shouldn't be balanced on our backs alone. I think the Legislature should do its share."

DONALD BERTRAM

Highway Patrol Officer from 1957–1967

"I joined the Highway Patrol in 1957, where I served for 10 years until a drunk driver smashed into my patrol car on March 13, 1967. Pinned under the car, I had back and leg injuries that forced me to go into retirement. My gross retirement check is $724 a month. With IDDA and EPDA benefits I receive an extra $372.53. If Cal-Tax has its way, I would lose my IDDA and EPDA benefits and I would have to live on $724 a month. I don't know how I could do it. Since the Highway Patrol never was part of Social Security, $724 a month would be all I would get."

DELBERT LEHR

Account Clerk, State Board of Equalization, from 1978-1985

"I worked both in the private sector and the public sector. While I liked working for the state, we never had many of the benefits of private sector employees. The state doesn't have profit sharing or stock option plans. What it has is a pension plan. Nevertheless, I didn't mind buying my pension with 5 percent of my salary even though most private sector pensions are financed through employer contributions. But since a high percentage of our pension account is from our own investment, we should receive that money."

ZORKA ENOS

Clerk II, Franchise Tax Board, from 1953–1975

"When I worked for the state we were not hooked up with Social Security, so I'm dependent upon my state pension. After 20 years with the Tax Board, I received around $350 a month in pension. Over the last 16 years, inflation has eaten away my pension, making it harder and harder to live on. In 1984, we started to receive IDDA checks which brought me up to 75 percent of what my pension check was worth in 1975. Now Cal-Tax wants to take that away from us, letting inflation take away our pension. I don't think that is fair."

MARY WALKER

Receptionist, General Services, from 1951–1978

"I have to depend upon myself, I don't have anyone else. I worked 27 years for the state and I really liked my job. I liked meeting people and that is what I was able to do as a receptionist. Now that I'm retired I don't want to live it up but I want to feel safe. So, I think it's really lousy that these large rich corporations want us to lose our pensions to inflation when they don't want to pay their share of taxes."

JAMES RHODES

Correctional Officer, Department of Corrections, from 1955–1973

"I was proud to work for the state for eighteen years. One of the reasons I worked for the state was to be secure in my retirement. While the state doesn't have profit sharing or stock plans, I thought it had a good retirement plan. In 1973, a $477 pension was not too bad. But our state pensions have not gone up with inflation. Our state pension should be like Social Security and go up with inflation."

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Myth:

State employees receive better pensions than private sector employees.

Fact:

State employees receive lower pensions than their counterparts in large corporations. And if Cal-Tax, a lobbying group for California's largest corporations, has its way, state employees won't be secure in their retirement — even after 20 years of service and Social Security.

In order to preserve California's low corporate tax rates, Cal-Tax, the lobbying group for large state corporations, wants to slash the state employee pensions. Saying they believe "private sector benefits are an appropriate standard by which to measure the adequacy of public sectors," Cal-Tax charges that the "public retirement benefits exceed what is needed to provide adequate retirement income."

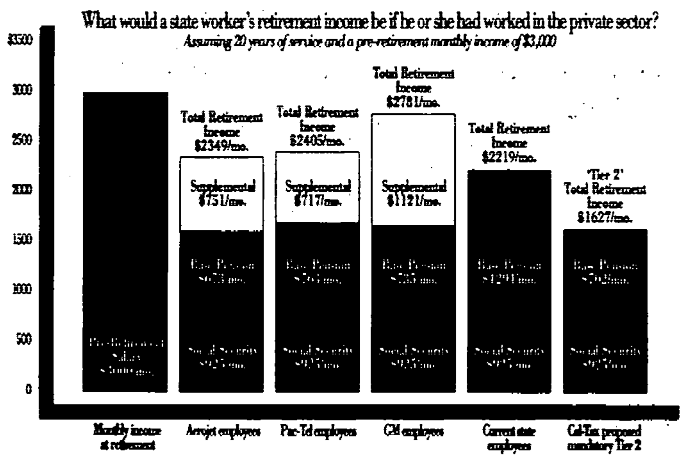
Are state pensions excessive? The average retired state employee receives a $689 monthly pension after working for the state for 17 years. How can Cal-Tax say that a $689 pension is excessive?

Almost all large corporations have two parts to their retirement plans, something Cal-Tax fails to mention. The first is a straight pension fund which is paid for entirely by the employer, and guarantees the employee a certain minimum monthly pension. The second part is a supplemental plan, such as a 401K, which is paid for by employee contributions, a certain percentage of which are often matched by the employer. The money employees put into a supplemental plan is invested in stocks, bonds, and mutual funds, and if the investments do well, as nearly all investments did in the 1970s and 1980s, retirees receive the benefits of their investments.

For example, a retiring Aerojet employee making $3,000 a month with 20 years of service who participated in Aerojet's supplemental pension plan would receive a $673 monthly pension, and a $751 check each month from the supplemental plan. A retiring Pacific Telesis employee would receive $763 a month from the pension and $717 from the supplemental plan.

But the state doesn't have two separate pension plans — it has only one, the California Public Employees' Retirement System (PERS). State employees contribute an average of 6 percent of their income to this plan, and the employee contribution and the state's contribution are combined to determine the employee's final pension. If you are a state employee and you have a supplemental plan there is no employer participation or contribution. And until the introduction of Individual Dividend Disbursement Account (IDDA) checks in 1984, state pensions only went up 2 percent a year, even though the inflation rate was much higher. Retirees did not receive any extra benefits if their investments did well.

Cal-Tax wants to take away the IDDA protection, and cut benefits even further, seriously penalizing state employees under the guise of balancing the state budget.



Myth:
The state's employee pension plan offers adequate inflation protection.

Fact:
The state pension fund has less inflation protection than Social Security.

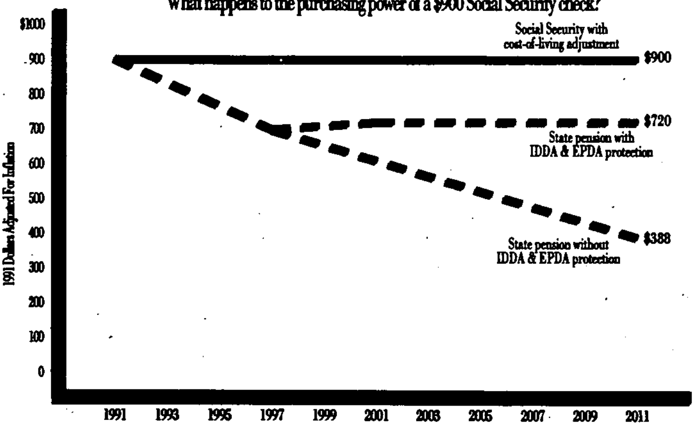
While Social Security has automatic cost of living adjustments (COLAs), the state pensions only have a 2 percent cost of living adjustment. If inflation is greater than 2 percent, as it has been for the last 20 years, the buying power of a state pension goes down every year. After only 10 years of 6 percent inflation a pension check will have lost one-third of its value.

Inflation is a double-edged sword, however. Inflation will gradually reduce the value of a monthly pension check, but inflation also ensures the growth of invested funds. All pension funds are invested, including the $63 billion PERS fund. In a standard supplemental pension plan, retirees receive dividends from their invested money but, until the introduction of IDDA in 1984, the state's pension plan didn't offer any way for retirees to receive dividends from their own invested funds.

What is IDDA? The Individual Dividend Disbursement Account (IDDA) is a program which pays dividends to retirees from *their* invested funds if the investments do better than 8.5 percent per year. These dividends are used to protect state employees from inflation, keeping their pension at 75 percent of their retirement salary, adjusted for inflation. This year retirees began receiving Extraordinary Performance Dividend Account (EPDA) checks, which restore the purchasing power of retirees' checks to 80 percent of their retirement salaries if the PERS investments do very well.

However, if the PERS investments don't do better than 8.5 percent, there is no inflation protection and state employees receive no benefits from their invested funds except their basic retirement. There are no such restrictions on private sector supplemental retirement plans, and private sector pension checks are not artificially limited to 75 percent of an employee's retirement salary.

What happens to the purchasing power of a $900 state pension check in 20 years with 6 percent inflation?
What happens to the purchasing power of a $900 Social Security check?



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Myth:

State employees' investments in the state pension fund produce the same benefits as private-sector retirement investment plans.

Fact:

When private sector employees invest their own money in a pension plan, they receive all the investment income from the plan. State employees have contributed a mandatory 5%-8% of their salaries to the state pension fund, but over the last 7 years have received only part of their investment income. The rest went to the state.

For example, say a private sector employee invests 6 percent of his or her wages into a private pension plan, expecting the plan to produce an 8.5 percent return. If the plan's investments perform better than expected, earning 10 percent instead, the employee keeps the extra money.

In a private sector supplemental pension plan all investment dollars earned from employee contributions go to the employees in a private fund.

But if a state employee invests 6 percent of his or her wages into the PERS pension fund, expecting an 8.5 percent return, and the fund earns 10 percent instead, the state keeps more than half of the extra money. Over the last 7 years, only 45 percent of excess earnings generated by employee contributions have gone back to the employees through IDDA and EPDA. The other 55 percent went back to the state, and the state used that money, a total of *$1.2 billion*, to reduce its contribution to the PERS pension fund — something no private sector employer is allowed to do.

Due to high inflation during the 1970s and 1980s, PERS investment funds earned more than the expected 8.5 percent return. Now, however, inflation is down and so are investment returns. But Cal-Tax is urging Governor Wilson to apply some creative bookkeeping to balance the budget — they want to assume that PERS investments will continue to earn more than 9.5 percent. If they succeed, the state can legally reduce its contribution to the pension fund by $319 million a year, which sounds good. But since the fund probably won't earn more than 9.5 percent, IDDA and EPDA payments will be cut, eliminating the small amount of inflation protection built into the state pension system. Further, imposing false financial assumptions on the retirement system in order to reduce employer contributions may jeopardize the fund's integrity just as the federal government has weakened Social Security with IOU financing.

Since 1984, the employee-contributed portion of the PERS fund has earned over the expected amount. Only 45% of these earnings have gone to employee IDDA and EPDA funds. 55% of these earnings have gone back to the state.

Myth:

The state can cut its contribution to the state pension fund and still provide an adequate pension plan.

Fact:

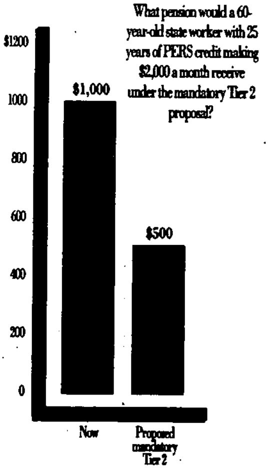
Governor Wilson plans to make the 'Tier 2' pension plan mandatory for all new state employees, which would effectively eliminate a secure state pension system.

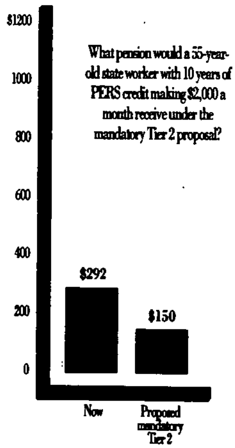
A state employee making $2,000 a month who retires at age 60 with 25 years of service currently would receive a $1,000 monthly pension. Under the proposal to make 'Tier 2' mandatory, the same employee's pension would be only $500 a month.

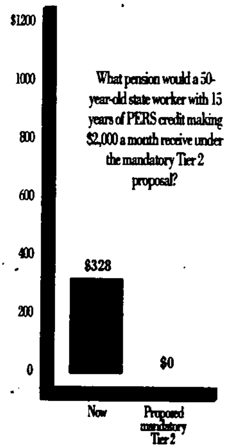
Under the current provisions, individuals with over 5 years of PERS credited service who are over 50 years of age are eligible for retirement benefits. Under the proposed mandatory Tier 2 provisions an individual will not receive any benefits until they have 10 years of PERS credited service and are over 55 years of age.

Not only would the mandatory Tier 2 provisions dramatically cut employee pensions, they would also over time end the IDDA and EPDA inflation protections for current employees. This is because the Tier 2 program eliminates employee contributions to the fund.

And if the Governor Wilson-proposed mandatory furlough for state employees is enacted, they will not only receive a 5 percent pay cut, but it will also reduce their pension fund.







Myth: [illegible]

Fact: Cal-Tax is run by, and for, the largest California corporations — not for the average taxpayer.

A partial list of Cal-Tax Board of Director Companies

AT&T
Robert Allen, chairman and chief executive
[illegible] Madison Avenue, New York, NY [illegible]
[illegible]

Atlantic Richfield Co. (ARCO)
Lodwrick Cook, chairman and chief executive
515 S. Flower Street, Los Angeles, CA 90071
[illegible]

Bank of America
[illegible], chairman and CEO
555 California Street, San Francisco, CA 94104
(415) [illegible]

Carter Hawley Hale Stores, Inc.
Philip Hawley, chairman and chief executive
550 Flower Street, Los Angeles, CA 90071
(213) [illegible]

Chevron USA Inc.
[illegible], president
575 Market Street, San Francisco, CA [illegible]
(415) [illegible]

E & J Gallo Winery
Ernest Gallo, chairman of the board
Julio Gallo, president
[illegible] Yosemite Blvd., Modesto, CA [illegible]
[illegible]

Exxon Company, USA
[illegible], president
[illegible] Bell Avenue, Houston, TX [illegible]
(713) [illegible]

Fireman's Fund Insurance Companies
William McCormick, chairman, president and CEO
777 San Marin Drive, Novato, CA [illegible]
[illegible]

General Motors Corporation
Roger Smith, chairman and CEO
[illegible] W. Grand Blvd., Detroit, MI [illegible]
(313) [illegible]

Great Western Financial Corporation
James Montgomery, chairman and CEO
[illegible] Wilshire Blvd., Beverly Hills, CA [illegible]
[illegible]

Home Savings of America
[illegible], chairman and CEO
[illegible] Drive, Irwindale, CA [illegible]
(818) [illegible]

J.C. Penney Company
William [illegible], chairman and CEO
[illegible] N. Dallas Parkway, Dallas, TX [illegible]
(214) [illegible]

Longs Drug Stores
R.M. Long, president and CEO
141 N. Civic Drive, Walnut Creek, CA [illegible]
(415) [illegible]

Nissan Motor Corporation in USA
[illegible], president
[illegible] S. Figueroa St., Carson, CA [illegible]
(213) [illegible]

Pacific Gas & Electric
Richard A. Clarke, chairman of the board and CEO
77 Beale St., San Francisco, CA [illegible]
(415) [illegible]

Philip Morris USA
[illegible], president and CEO
120 Park Avenue, New York, NY [illegible]
(212) [illegible]

Ralphs Grocery Company
[illegible], chairman
[illegible] W. Artesia Blvd., Compton, CA [illegible]
(213) [illegible]

Safeway, Inc.
Peter A. Magowan, chairman and CEO
4th and Jackson Streets, Oakland, CA [illegible]
(415) [illegible]

Shell Oil Co.
[illegible], president and CEO
P.O. Box [illegible], Houston, TX [illegible]
(713) [illegible]

Texaco, Inc.
Alfred C. DeCrane, chairman
James W. Kinnear, president and CEO
2000 Westchester Ave., White Plains, NY [illegible]
(914) [illegible]

Transamerica Corporation
James Harvey, chairman and CEO
600 Montgomery Street, San Francisco, CA [illegible]
(415) [illegible]

Union Oil Company of California
[illegible], chairman and CEO
P.O. Box [illegible], Los Angeles, CA [illegible]
(213) [illegible]

Wells Fargo Bank
[illegible], chairman
420 Montgomery Street, San Francisco, CA [illegible]
(415) [illegible]

Myth: California needs to slash state employee pensions to balance the state budget.

Fact: There are many ways to balance the state budget that are much more equitable than drastically cutting [illegible] employee [illegible]

Cutting state employee pensions will save the state a total of $500 million.
Here are some ways to save $6 billion that Cal-Tax doesn't want you to know about:

Closing the major loopholes in the bank and corporation tax will raise ....$2 billion
Closing a loophole in the state property tax laws will raise ....$1–2 billion
Increasing the top income tax rate on incomes over $200,000 will raise ....$1.7 billion
An oil severance tax like every other oil producing state has will raise ....$500 million
Total raised: $5–6 billion

These measures will make California's tax system a fair one, by closing loopholes and increasing taxes only on those who have avoided paying their fair share. These provisions will affect many Cal-Tax member corporations; maybe that is why Cal-Tax is fighting so hard to preserve corporate loopholes.

California State
Employees Association
1108 "O" Street
Sacramento, CA 95814

Californians for a Sound Future
member organizations include:

California Association of Highway Patrolmen (CAHP)
California Association of Psychiatric Technicians
California Correctional Peace Officers Association (CCPOA)
California Department of Forestry Employees Association
California State Employees Association (CSEA)
California Union of Safety Employees (CAUSE)
Retired Public Employees Association (RPEA)
Union of Physicians and Dentists

Nonprofit Org.
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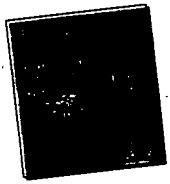
INSIDE: THE MYTHS OF STATE EMPLOYEE PENSIONS



Petition Form

TO: ____________________

As concerned citizens of the State of California, we petition the Governor and the Legislature not to support California Taxpayers Association's misrepresentations which would ultimately destroy the future of active and retired state employees. We request that you consider the years of dedicated service that these people have given to the State of California. Do not "reward" that commitment by eliminating their pensions, health benefits and hopes that they will live their "golden years" secure and adequately cared for. The threats to the Public Employees' Retirement System represent an individual threat to each and every state employee who worked hard to attain this security. We believe you will agree that Cal-Tax proposals to eliminate retirement benefits is both unfair and shortsighted. Please help us maintain a fair and secure retirement system.

FROM:

Name__________ Name__________
Name__________ Name__________
Name__________ Name__________

Additional Threats To Public Employees As A Result Of The Budget Crisis:

Health Care: Current proposals will result in huge out-of-pocket increases for state employees, active and retired. For example, PERS-Care members who have no other health care options could ultimately end up paying more than $200 out-of-pocket for a family health care plan.

Furloughs: Mandatory furloughs have already been proposed for non-represented employees — we're next!

Lay-offs: Lay-offs are a very real threat and have been discussed by the current administration.

Pensions: Recent legislation which changed the retirement calculation rate from 3 years to 1 year is also in jeopardy.

Pay: There will be no pay increases, no merit or cost-of-living increases, and a 5 percent pay cut for each of us — a 5 percent tax only on state employees.

Send copies of the petition at left to the companies listed on page 6 and the individuals listed below:

Governor Pete Wilson
State Capitol, Sacramento, CA 95814

Senate President Pro Tem David Roberti
Senate Majority Leader Barry Keene
Senate Minority Leader Ken Maddy
Senator Frank Hill

The Honorable __________
California State Senate
P.O. Box 942848, Sacramento CA 94248-0001

Assembly Speaker Willie Brown
Assembly Majority Floor Leader Thomas Hannigan
Assembly Minority Floor Leader Ross Johnson
Assembly Member Phil Isenberg

The Honorable __________
California State Assembly
P.O. Box 942849, Sacramento, CA 94249-0001

A publication of Californians For A Sound Future