Testimony of John Pelletier to the House Government Operations Committee
Friday March 26, 2021 at 1:00 PM

Madame Chair

My name is John Pelletier, and I am the Director of the Center for Financial Literacy at Champlain College. I am here today in my capacity as a member of the Vermont Business Roundtable's Pension Reform Task Force and as one of the co-authors of this group's 2020 report on policy options available to the General Assembly that could help put Vermont's state employees' and teachers' pension and health care retirement systems on a sustainable path for the future.

I have been asked by you to provide testimony on the Chair and Vice Chair's pension reform proposal. Before I give you my thoughts on this proposal, I want to explain to this committee why I got involved with this pension issue back in 2016. I have the good fortune of working with many of Vermont's amazing educators. Since 2011 our Center has provided free financial literacy professional development opportunities to our educators. In fact, right now, our Center is running a free, online, on-demand program with approximately 500 Vermont educators registered.

I have been concerned for years that retirement pension benefits for teachers were at risk due to poor investment performance and unrealistic assumed rates of return and other actuarial assumptions. A funded ratio of 51% for the teachers plan is frankly unacceptable. It is terrible for the state, the taxpayer, but ultimately terrible for the many teachers counting on this plan for predictable retirement income.

Few if any of the educators I work with understand just how precarious their pension benefit is. That is why I got involved, to make sure these teachers who may not retire for 10 or 20 or 30 years have safe and predictable pension benefits in their old age. I have had a sense of urgency around this topic for the past half decade, and I am very grateful that this committee shares this same sense of urgency.

In my previous testimony to this committee on the topic of pensions, I told you that the north star you should steer towards when you craft your proposed changes, should be one that puts these plans on a clear path toward long-term sustainability, predictability, affordability and fairness. In addition I would add that for these changes to be successful the pension reforms must align the economic incentives of the employer, the employees and the taxpayers. All must want the same outcome, a fully funded pension system, because it is in their long-term personal, economic and political interests.

I believe that the Chair and Vice Chair's pension proposal successfully addresses all of these items. I strongly support these proposals.

Sustainability

The pension proposal will put these plans on the path to sustainability. Currently these plans have nearly $3 billion in unfunded liabilities as of the end of FY2020. A one-time investment into the plans of $150 million by the state would reduce the unfunded liabilities by $459 million. The cumulative impact of all other proposed benefits changes would reduce the unfunded liability by $519 million. Even with these changes, the unfunded pension liability would still be a daunting $2 billion. But these changes would reduce that total liability by one third.

Predictability

The pension proposal will make the annual ADEC contributions much more predictable from a budgetary standpoint. These costs would continue to go up between now and 2038, but at a more manageable rate of increase that is much less likely to force the General Assembly to make drastic cuts to other necessary services provided by the state.

Affordability

The proposed changes makes the pension plans more affordable, by eliminating most of the large, unplanned nearly $100 million increase to the ADEC in FY2022 and in future fiscal years. The proposals reduce the unplanned ADEC cost increase by 83% in FY2022.

Fairness

I think that having cost-sharing mechanisms in place on these plans is fair to the taxpayer. Putting one hundred percent of all investment, actuarial, economic and market risk exclusively on Vermont taxpayers is inherently unfair.

I think fairness to the impacted employees requires that two items in this proposal be specifically addressed. First the employees and the state of Vermont should contribute equally to the decrease in the unfunded pension liabilities. Currently the employees are being asked to bear 53% of the unfunded liability reduction while the state government bears only 49% (the total reduction in unfunded liability is $938 million, with $519 million funded by the employees and $459 million funded by the employers). Increasing the state's one-time payment to $170 million would reduce the unfunded liability by $520 million, basically the same dollar amount that employees are being asked to bear.

I do not believe it is fair to equally distribute the one-time payment by the state to each of the plans. While the state employees' plan was basically fully funded each year, the teachers' plan was not for many years from 1991 to 2006. In addition, unlike the state employees' plan, the teachers' plan had medical appropriations of about $176 million taken out of plan assets since 2007. Primarily for these reasons, the state employees 66% funded ratio is 15% higher than the teachers 51% funded ratio. Given these facts, the fairest way to allocate the one-time investment into the plans by the state is based on each plans' percentage of total unfunded liabilities. Currently the state plan has about $1 billion in unfunded liabilities and the teachers' plan has about $1.9 billion. Using this formula, the state employees' plan should receive 35% and the teachers plan 65% of the one time investment of funds into the plans by the state.

Alignment of Economic Incentives

The proposal aligns the interests of all parties. The General Assembly and the Governor will not want to have unplanned increases in the ADEC that will result in cuts to other essential programs. The employees in these plans will not want to have the cost sharing mechanisms be triggered (either the contribution rate increase or the COLA decrease). Employees will want strong investment performance on their pensions and will want their pension plans to have a funded ratio in excess of 85% as soon as is practicable. Taxpayers are not likely to support major increases to their taxes or decreases in essential services from the state to provide retirement and health care benefits that only 15% of private sector workers nationally even have access to in the workplace (see December 2020 Congressional Research Report attached to my testimony). All stakeholders will want conservative and realistic assumed rates of return and actuarial assumptions and, more importantly, all will demand above median performance from the managers of these pension plans. Going forward, the goal of all stakeholders will be to have many more surprises on the upside rather than the downside—the exact opposite Vermont's actually pension plan experience over the last 20 years.

Conclusion

The economic incentives created by these proposals, when combined with pension governance enhancements, give me a great deal of hope that Vermont's unfunded pension liability problems can be solved over the next ten to fifteen years. I strongly support the Chair and Vice Chair's pension proposals.

I am happy to answer any questions that you may have with regard to these topics.