

Proposed Municipal Pension Recovery Program
HB 1874 and 1884

The Problem:

Municipalities are experiencing unprecedented investment losses as well as a decline in municipal tax revenues.

A Solution:

To provide short-term budgetary relief to all local governments as well as provide a long-term approach to resolving the underfunded condition of certain municipalities that are unlikely to achieve adequate funding on their own.

NEW ACT 205 RECOVERY PROGRAM Act 205 of 1984 established funding requirements for all municipal pension plans, except counties. The original enactment included a fifteen year recovery program and supplemental state assistance for distressed pensions, which have expired. This proposal establishes a new recovery program to be initiated with the 2009 actuarial valuation period.

For *all* municipalities:

1. Revised amortization schedules for future plan changes-

<u>CURRENT</u>	<u>PROPOSED</u>	<u>RATIONALE</u>
<ul style="list-style-type: none"> - experience (investments) over 15 years - assumption changes over 20 years - active member benefits over 20 years - retiree benefits over 10 years 	<ul style="list-style-type: none"> - experience (investments) over 20 years - assumption changes over 15 years - local benefit changes over 10 years - state mandated benefit over 20 years 	<p>Compels prompt payment of obligations created by local action, while allowing more time for changes resulting from circumstances beyond municipal control.</p>

2. Asset smoothing based upon market cycles (tabular value asset reserve method), with a temporary (2-year) 30% limit on the variation of actuarial value of assets above or below market value.

For *distressed* municipalities:

Distress determination based upon aggregated ratio of assets to liabilities, using the most recent actuarial valuation report.

LEVEL 1 – Municipalities with an aggregate funded ratio **between 70% and 89%** would be classified as Level 1 (minimal distress).

Voluntary remedies-

- the aggregation of pension funds for administration and investment
- utilization of the special taxing authority under Act 205
- may pay 75% of the amortization contribution requirements for 2 years
- increase in the asset smoothing corridor for recognition of gains and losses from 20% to 30% for an additional 2 years beyond that provided for in the 2009 valuation period

LEVEL 2 – Municipalities with an aggregate funded ratio **between 50% and 69%** would be classified as Level 2 (moderate distress).

Voluntary remedies-

- utilization of the special taxing authority under Act 205
- may pay 75% of the amortization contribution requirements for 4 years
- increase in the asset smoothing corridor for recognition of gains and losses from 20% to 30% for an additional 4 years beyond that provided for in the 2009 valuation period

Mandatory remedies-

- the aggregation of pension funds for administration and investment
- submission of a plan for administrative improvement

LEVEL 3 – Municipalities with an aggregate funded ratio **below 50%**, and with an unfunded actuarial accrued liability of \$50,000, would be classified as Level 3 (severe distress).

Voluntary remedy-

- utilization of the special taxing authority under Act 205

Mandatory remedies-

- increase in the asset smoothing corridor for recognition of gains and losses from 20% to 30% for an additional 4 years beyond that provided for in the 2009 valuation period
- fresh start: all existing liabilities reset with a new 30-year level dollar amortization period
- deferral of full amortization contribution requirements over a 5 year period, at 20% per year

All municipalities with severely distressed pension plans (level 3 only) will be administered by the Commonwealth through the Pennsylvania Municipal Retirement System (PMRS), which has the experience and capacity to administer the wide variety of pension benefit plans anticipated.

- all pension assets, along with all plan documents, ordinances, contracts, etc. of the plans will be transferred to PMRS, which will administer the plans in accordance with existing municipal pension terms and conditions. These plans remain the financial responsibility of the municipalities; retain their own assets, liabilities and plan experience; but are pooled for investment and administrative purposes.
- no change of plan provisions are permitted, and all earnings will be applied to each fund, pro-rata
- all PMRS expenses will be subject to the State budgetary process, to be paid from plan assets, and each municipality will remain solely liable for its own pension plan obligations
- PMRS will annually bill the participating municipalities for their respective minimum municipal obligation payments. Once all plan liabilities are paid, any remaining plan assets will be applied against each municipality's future obligations to the plan for new hires.

All new hires of municipalities with severely distressed pension plans (level 3 only) will be mandatory enrolled into one of four, uniform or municipal pension plans created under the Cooperative Municipal Pension and Security Program.

The following is the draft framework for the proposed benefit structures:

	<u>Cities</u>	<u>Boros, Twps, etc.</u>
Public Safety:	PS-1	PS-2
Nonuniformed:	N-1	N-2

PS-1: benefit accrual at 2.25 % per year, 6.75 % member contribution rate, normal retirement upon 20 yrs of service & age 50

PS-2: benefit accrual at 2.0 % per year, 6.0 % member contribution rate, normal retirement upon 25 yrs of service & age 55

N-1: benefit accrual at 2.0 % per year, 6.0 % member contribution rate, normal retirement upon 30 yrs of service & age 65

N-2: benefit accrual at 1.5 % per year, 4.5 % member contribution rate, normal retirement upon 30 yrs of service & age 65

(in each case, the member contribution rate is 3 times the benefit accrual rate)

- not subject to collective bargaining or local control
- survivor benefits may be payable to a designee, and funded by an actuarial equivalent reduction to the member's benefit
- disability benefits for work-related injuries will be 70% of the final average salary, less any Workers' Compensation received, while non-work-related disability benefits will be based upon benefits earned to date
- Final Average Salary for benefit calculation to be average compensation paid over highest three consecutive years of service

<u>CURRENT LAW</u>	<u>PROPOSAL</u>	<u>RATIONALE</u>
<p>Voluntary approximation, or smoothing, techniques based on fixed time periods and actuarial value of assets subject to 20% limit above or below market value.</p>	<p>Voluntary approximation, or smoothing, techniques based upon market cycles, with temporary 30% limit above or below market value.</p>	<p>Less arbitrary and better able to restrain contribution volatility. Reduces the impact of recent market losses.</p>
<p>30 year amortization for all unfunded actuarial liabilities existing in 1985, with subsequent gains & losses amortized as follows:</p> <ul style="list-style-type: none"> • Experience (investments) 15 yrs. • Assumption changes 20 yrs. • Active member benefits 20 yrs. • Retiree benefits 10 yrs. 	<p>Future amortization schedules based upon whether the municipality does or does not have control over the change:</p> <ul style="list-style-type: none"> • Experience (investments) 20 yrs. • Assumption changes 15 yrs. • Local benefit change 10 yrs. • State mandated benefit 20 yrs. 	<p>Compels prompt payment of voluntary changes, while allowing more time for changes resulting from circumstances beyond municipal control.</p>
<p>Distress determination based on 500 point scale, arrived at by 7 actuarial and 8 financial calculations, using data of questionable validity.</p>	<p>Distress determination using ratio of assets to liabilities, based upon most recent actuarial valuation report.</p>	<p>Readily calculated / predicted by the municipality and its employees. Funded ratio consistent with IRC §432.</p>
<p>Requires annual payment of normal cost (value of benefits earned this year), expenses, and amortization contribution.</p>	<p>Requires payment of normal cost and expenses, but provides partial relief from amortization contribution requirement.</p>	<p>Holds the line on payment of new costs. Helps with current budgetary difficulties.</p>