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Government Finance Officers Association of Pennsylvania

All Things Pension

Mockenhaupt Presentation | May 21, 2024



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All Things Pension

- Pension plan types
- Laws governing PA pension plans
- Act 205 requirements
- Roles of the CAO and Actuary
- Actuarial Valuation Reports
- MMOs and State Aid
- Pension administration calendar
- Trends in Plan Design
- Police Regionalization
- Proposed Legislation
- Tips, Takeaways and Reminders



Types of Municipal Pension Plans

Defined Benefit Plans – The employer provides a definite benefit, at a specified retirement date (based on age and/or service). Benefits are paid monthly for the retiree’s life and may continue to a beneficiary.

Defined Contribution Plans – A defined amount of money is deposited into the pension fund on behalf of each eligible employee. The benefit at retirement is equal to the balance in the fund (accumulated contributions and earnings/losses).

Hybrid Plans - Some plans blend elements of defined contribution and defined benefit plans into a single plan known as a “hybrid” plan.

Multi-Employer Plans - Usually provided through a labor union, the employer makes a fixed contribution based upon the terms of a collective bargaining agreement. The plan could be a defined benefit or defined contribution.



What Governs PA Municipal Pension Plans?

Pennsylvania municipal plans may be governed by one of the following statutes:

- Act 600
- Pennsylvania Municipal Retirement Law (PMRS)
- Third Class City Code
- Borough Code
- First Class Township Code
- Second Class Township Code
- Act 96 County Pension Law

All Plans are governed by the regulations of Act 205 (non-counties) or Act 293 (counties)



Additionally...

- **Government Pension Plans are Different than Private Plans**
 - Government plans are exempt from the provisions of the Employee Retirement Income Security Act (ERISA), the major legislation governing private plans.
- **Constitutional Protection**
 - The Pennsylvania Supreme Court protects public employee pensions. Specifically, public employees' pension benefits cannot be taken away unilaterally, whether by statute, ordinance, or other action.
- **Fiduciary Responsibility**
 - The ultimate responsibility for any pension plan rests with the governing body. A fiduciary relationship imposes a duty to act in good faith and candor, with special regard to the interest of the person who places this trust and confidence in the fiduciary.



Act 205 Requirements

Defined Benefit & Defined Contribution Plans

Defined Benefit (DB) Plans:

- Biennial Valuations
- Biennial Act 205 filings
- Annual MMO calculations
- Payment of MMOs by 12/31
- Additional Requirements for Distressed Pension Systems
- Preparation of an actuarial study prior to benefit modification
- Professional Service Provider Selection guidelines
- Annual reporting of participants and payroll to AG for state aid
- Pennsylvania Act 600 and the Third Class City Code **mandate** DB plans for public safety employees.

Defined Contribution (DC) Plans:

- Biennial Act 205 filings
- Annual MMO calculations
- Payment of required employer contributions annually
- Professional Service Provider Selection Guidelines
- Annual Reporting of Participants and Payroll to AG for state aid calculations



Chief Administrative Officer (CAO)

- The Chief Administrative Officer is the person who has primary responsibility for the execution of the administrative affairs of the municipal pension plan, or the designee of that person.
- It should be someone familiar with state regulations and involved in the day-to-day interactions with the pension plan.
- Annually, Act 205 requires the Chief Administrative Officer of the pension plan to determine the total financial requirement and the required municipal contribution, known as the Minimum Municipal Obligation (MMO), for the next year and to certify the calculations.
- The CAO must present the MMOs to the governing body by September 30th for the next budget year.
- Additionally, the CAO should coordinate maintenance of pension records.



Pension Record Maintenance

■ Active Members of Plan

- Enrollment Form for each member (including birth date, hire date, plan participation date, and beneficiary)
- Annual salary (gross pay and pension wages, if different)
- Annual employee contribution records
- Records regarding breaks in service
- Beneficiary information
- Military service purchase

■ Inactive Members of Plan

- Letter of resignation/Application for retirement
- Final Average Pay calculations
- DROP agreements
- Accumulated contribution records
- Retirement or Vested Benefit Calculation
- Beneficiary designation and current address
- Contribution Refund Calculation - Rollover Forms
- Signed benefit election form



Pension Record Maintenance

- **Financial Statements of the Plan**
 - Annual account values
 - Asset balance categorized by type of investment
 - Transaction ledgers
 - Annual reconciliation of plan assets
 - Audit reports (state and local)
- **Plan Reports and Filings**
 - Forms prepared for filing with Department of Auditor General
 - Minimum Municipal Obligation (MMO) calculations
 - Cost studies
 - Correspondence regarding plan benefits, costs or audit problems
- **Plan Documents**
 - Ordinances/Resolutions
 - Collective Bargaining Agreements
 - Arbitration Awards
 - Determination Letters
 - Legal Opinions



Role of the Consulting Actuarial Firm

- The Consulting Actuarial Firm assists the government entity with administration and compliance of their plans. We provide specialized actuarial advice and certification of actuarial reports and studies as well as complex calculations. At Mockenhaupt, our goal is to provide a fair, accurate and unbiased picture of the plans' funding status. Our primary concern is the actuarial soundness of the plans for the benefit of all plan participants and beneficiaries.
- An Actuary must have at least five years of actuarial experience with public pension plans and who is either enrolled as a member of the American Academy of Actuaries or enrolled as an actuary pursuant to the Federal Employee Retirement Income Security Act of 1974.



The Actuarial Valuation Report

- A snapshot of a plan's funded status at a given point in time
- Sets the funding requirements (MMOs) for the next two years (or one or three years depending on timing)
- Act 205 (of 1984) requires Biennial Actuarial Valuation Reports
- Prepared as of the beginning of odd-numbered years
- Must be filed by March 31 of the following year
 - January 1, 2025 to be filed by March 31, 2026

Funding Goals

- To ensure there's enough money to pay benefits when due
- Intergenerational Equity - Allocate costs in a way that's reasonably related to services rendered
- Smooth costs



Actuarial Assumptions & Cost Method

- Best estimate actuarial assumptions are used to project the payments to be made from the pension fund and future investment earnings.
- Do actuarial assumptions matter?
 - Only in the allocation of costs to different time periods
 - Experience is what drives plan costs long-term
- When deviation occurs (and it will) costs go up (when experience is worse than assumed) or down (when experience is better than assumed)
- The actuarial cost method (Entry Age Normal Cost) spreads the cost of future pension benefits over employees' careers



Basic Formula of Pension Funding

$$C + I = B + E$$

- C = Contributions
- I = Investment Return
- B = Benefit Payments
- E = Expenses

- B + E are what gets paid out of the plan
- C + I are what goes into the plan

Key Terms

- Normal Cost
 - The cost of an active participant's projected future pension benefits that is attributable to the current year of service



Key Terms

- Actuarial Accrued Liability (AAL)
 - The accumulation of all past Normal Costs (past service liability)
 - Theoretically the amount of assets that you should have
- Unfunded Actuarial Accrued Liability (UAAL)
 - Actuarial Accrued Liability (AAL) minus Actuarial Value of Assets (AVA)
- Funded Ratio
 - $AVA \div AAL$
- Amortization Payment
 - When $AAL > AVA$, the additional contribution to get to 100% funded ratio
- Funding Adjustment credit
 - When $AVA > AAL$, 10% of the excess of the AVA over the AAL (to get to 100% funded ratio)



Minimum Municipal Obligation (MMO)

- The MMO must be calculated annually and provided to the governing body by the CAO no later than the last business day of September
- The MMO amount certified must be included in the next year's budget.

MMO for Defined Benefit Plans

- Calculated based on the most recent AVR to include:
 - Normal Cost
 - Anticipated Administrative Expenses
 - Amortization Payment or Funding Adjustment Credit (based on funded status of the plan at the last valuation)
 - Employee Contributions

FINANCIAL REQUIREMENT AND MINIMUM MUNICIPAL OBLIGATION

A. Normal Cost

- 1. Normal Cost as a Percent of Payroll..... _____ %
- 2. Estimated 201X-1 Payroll for Active Participants \$ _____
- 3. Normal Cost (A1 x A2) \$ _____

B. Financial Requirement

- 1. Normal Cost (A3)..... \$ _____
- 2. Anticipated Administrative Expense..... _____
- 3. Amortization Payment, if any _____
- 4. Financial Requirement (B1 + B2 + B3)..... \$ _____

C. Minimum Municipal Obligation

- 1. Financial Requirement (B4)..... \$ _____
- 2. Anticipated Employee Contributions _____
(_____ % of Estimated Payroll)
- 3. Funding Adjustment, if any _____
- 4. Minimum Municipal Obligation (C1 - C2 - C3)..... \$ _____

NOTES:

- 1. 20____ General Municipal Pension System State Aid may be used to fund part or all of the municipal obligation and must be deposited within 30 days of receipt. Any remaining balance must be paid from municipal funds.
- 2. Deposit into the Plan's assets must be made by December 31, 20____ to avoid an interest penalty.
- 3. Any delinquent Minimum Municipal Obligation from prior years must be included in the 20____ budget along with an interest penalty.

I hereby certify that the above calculations, to the best of my knowledge, are true, accurate, and conform with the provisions of Chapter 3 of Act 205 on 1984.

Certified By:

Chief Administrative Officer
Prepared using the January 1, 20____ Valuation

Date



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MMO for Defined Contribution Plans

- Defined contribution plans also require a MMO certification to the governing body by the last business day of September
- BUT the amount calculated may not be equal to the actual employer contribution
- In a defined contribution plan, the MMO should be viewed as more of a “budget estimate”
- The actual contribution will be determined by:
 - The employer contribution rate in the agreement
 - Payroll (if contributions are pay-based)
 - Actual eligible participants
- The payroll budget amount that should be used for the MMO calculation should be the projected payroll for the budget year (upcoming year) including projected increases in salaries and number of members.



■ Amending the MMO

- An MMO may be amended after September 30 to increase the estimated payroll, or if a more current actuarial valuation report is completed.
- However, the final MMO must be adopted by the time the final municipal budget is adopted.

■ Paying the MMO

- State aid must be deposited to the plans within 30 days of receipt
- The balance of the MMO or employer contribution must be deposited to the plans by December 31.
- Any unpaid portion of the MMO after December 31 incurs interest penalty. The interest is calculated from the beginning of the plan year in which it was due through the month of payment, compounded monthly.



State Aid

Total State Aid is based on the collection of insurance premiums for insurance written in PA. Amount distributed each year is the greater of \$345 million or 38% of the taxes collected

The amount of State Aid available to each municipality is the lesser of:

- Financial Need of the Plans – determined using Act 205 reports for the municipality's plans and reported AG-385 payroll
- Unit Value = Number of Units (reported on AG-385) x unit value determined by the AG's office annually
 - Police = 2 Units
 - Firefighters = 2 Units
 - All Other Employees = 1 Unit



Example of Units vs. Need

| Financial Need Calculation: | Police Pension Plan | Non-Uniformed Pension Plan | DC Plan |
|--|---------------------|----------------------------|---------------|
| 1) Adjusted Normal Cost % (calculated from Act 205 filings) | 18.1761% | 10.4365% | 7.5% |
| 2) Payroll (AG-385) | <u>\$354,069</u> | <u>\$498,223</u> | <u>76,803</u> |
| 3) Adjusted Normal Cost (1 x 2) | \$ 64,356 | \$ 51,997 | 5,760 |
| 4) + Amortization Payment or - Funding Adjustment | <u>- 23,117</u> | <u>+ 57,623</u> | <u>0.00</u> |
| 5) Net Financial Need (3 +4) | \$ 41,239 | \$ 109,620 | 5,760 |

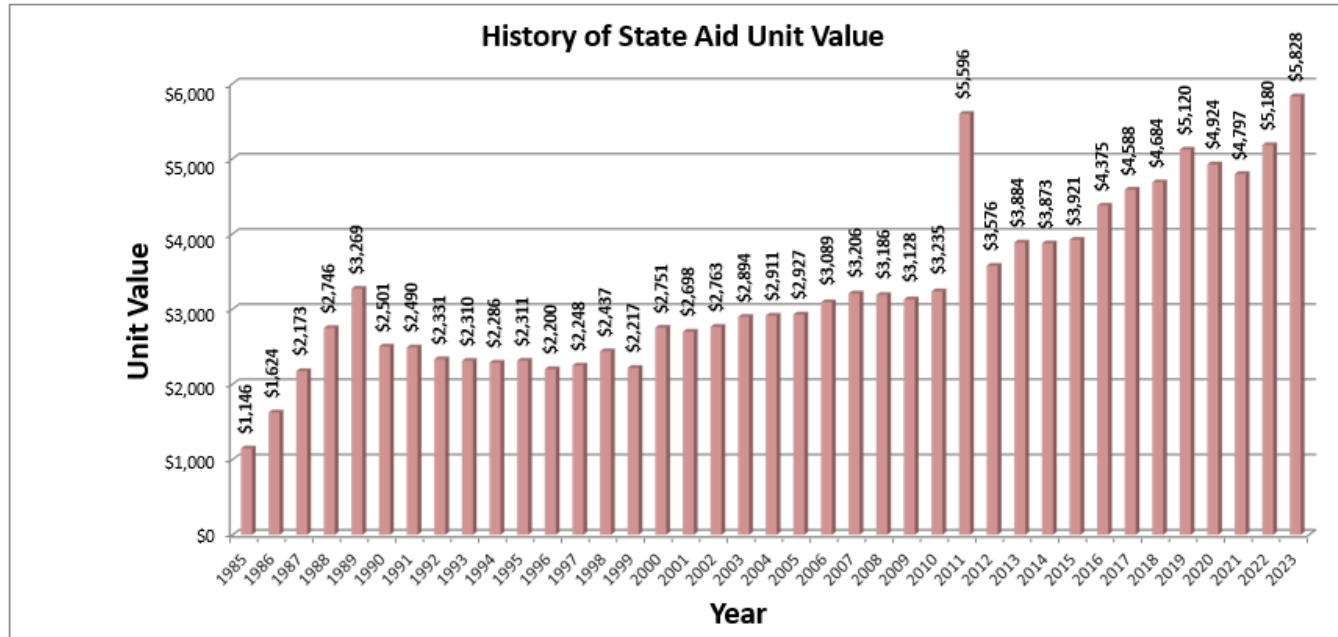
Total Financial Need for Borough = \$ 156,619



| Unit Value Calculation: | Police Pension Plan | Non-Uniformed Plan | DC Plan |
|--|----------------------|----------------------|----------------------|
| 1) Number of Employees | 5 | 10 | 2 |
| 2) Units per Employee | <u>× 2</u> | <u>× 1</u> | <u>× 1</u> |
| 3) Total Units (1 x 2) | 10 | 10 | 2 |
| 4) Unit Value (est. using 2023 unit value) | <u>\$ 5,827.8883</u> | <u>\$ 5,827.8883</u> | <u>\$ 5,827.8883</u> |
| 5) Total Unit Value (3 x 4) | \$58,279 | \$58,279 | \$11,656 |

Total Unit Value for Borough = **\$128,214**

State Aid Estimate is \$128,214



| Year | Unit Value | Percent Change | Year | Unit Value | Percent Change | Year | Unit Value | Percent Change | Year | Unit Value | Percent Change |
|------|-------------|----------------|------|-------------|----------------|------|-------------|----------------|------|-------------|----------------|
| 1985 | \$ 1,145.75 | | 1995 | \$ 2,311.25 | 1.1% | 2005 | \$ 2,926.77 | 0.5% | 2015 | \$ 3,920.83 | 1.2% |
| 1986 | \$ 1,624.04 | 41.7% | 1996 | \$ 2,199.69 | -4.8% | 2006 | \$ 3,088.52 | 5.5% | 2016 | \$ 4,374.65 | 11.6% |
| 1987 | \$ 2,173.36 | 33.8% | 1997 | \$ 2,247.51 | 2.2% | 2007 | \$ 3,206.39 | 3.8% | 2017 | \$ 4,588.25 | 4.9% |
| 1988 | \$ 2,746.48 | 26.4% | 1998 | \$ 2,437.46 | 8.5% | 2008 | \$ 3,186.33 | -0.6% | 2018 | \$ 4,684.39 | 2.1% |
| 1989 | \$ 3,268.71 | 19.0% | 1999 | \$ 2,216.66 | -9.1% | 2009 | \$ 3,128.01 | -1.8% | 2019 | \$ 5,120.50 | 9.3% |
| 1990 | \$ 2,500.58 | -23.5% | 2000 | \$ 2,751.05 | 24.1% | 2010 | \$ 3,234.84 | 3.4% | 2020 | \$ 4,923.83 | -3.8% |
| 1991 | \$ 2,489.57 | -0.4% | 2001 | \$ 2,698.21 | -1.9% | 2011 | \$ 5,596.43 | 73.0% | 2021 | \$ 4,797.28 | -2.6% |
| 1992 | \$ 2,331.48 | -6.4% | 2002 | \$ 2,762.97 | 2.4% | 2012 | \$ 3,576.11 | -36.1% | 2022 | \$ 5,180.45 | 8.0% |
| 1993 | \$ 2,309.91 | -0.9% | 2003 | \$ 2,894.40 | 4.8% | 2013 | \$ 3,884.36 | 8.6% | 2023 | \$ 5,827.89 | 12.5% |
| 1994 | \$ 2,285.78 | -1.0% | 2004 | \$ 2,911.36 | 0.6% | 2014 | \$ 3,872.68 | -0.3% | | | |



Pension Administration Calendar

■ January

- January 1 valuation date for most pension plans (required at least biennially for municipalities on odd-numbered years and for counties on even-numbered years)
- Begin compiling prior year-end data (census, payroll, assets etc.) to submit to actuary

■ March

- Biennial Act 205 Actuarial Valuation Report forms due to be filed with Department of Auditor General's Municipal Pension Reporting Program (MPRP) by the last business day (even-numbered years)
- Biennial Act 293 Actuarial Valuation Report forms due to be filed with Department of Auditor General's MPRP by the last business day (odd-numbered years)
- Form AG-385 due to be filed with Department of the Auditor General's MPRP by last business day for municipalities eligible for state pension aid



■ April

- Form AG-490 to be received by Department of the Auditor General before April 1 for municipalities eligible for ad hoc COLA reimbursement under Act 147 of 1988

■ August

- Ad hoc COLA reimbursement checks distributed around mid-month for eligible municipalities under Act 147 of 1988
- Auditor General's MPRP sends municipalities Act 205 Recovery Program Election forms with new Distress Scores (even-numbered years)

■ September

- MMO calculation must be submitted to governing body by end of month
- Municipal pension state aid distributed in last half of the month



- **October**
 - Act 205 Declaration submitted to MPRP online by mid-month (odd-numbered years)
 - Municipal pension state aid must be deposited to pension plans (or used to reimburse the general fund for payments already made to the plan for the current year) within 30 days of receipt
- **November**
 - Any revisions to MMO calculations should be made before the final municipal budget is adopted
 - Act 205 Recovery Program Election form due to be filed with the MPRP by the end of the month (or December 1) for municipalities eligible for and electing any remedies (even-numbered years)
- **December**
 - For Act 600 police pension plans, a resolution needs to be passed for next year if member contributions are going to be reduced below the mandated rate
 - MMO must be paid by end of month to avoid an interest penalty.



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Trends in Plan Design

Plan Design Limitations

- Governing Statutes
 - Act 600
 - Third Class City Code
- Collective Bargaining Terms / Process
- Protection of Benefits for Current Employees
 - Reduction may be made for new hires only
 - Still subject to Collective Bargaining for Union employees
 - Could permit current employees to voluntarily opt into new arrangement





DB to DC for New Hires

- Employer contribution rate can be set similar to the normal cost of the DB plan, for parity, or lower for potential savings
- While a DB plan has the potential for an employer contribution (MMO) to be \$0 based on plan funding levels, that is not possible in a DC plan
- Careful structuring as a continuation of the DB plan can avoid state aid waiting period applicable to new plans
- An additional Act 205 form and MMO must be prepared for the DC part of the plan
- Plan recordkeeping and pension fund must be established for the new plan.
- **HOWEVER**, several entities are currently considering a reversal
 - Re-opening DB plan to improve employee retention.



Plan Design Changes for Risk Management

- Lower benefit levels in a DB plan
 - One of few options for plans established pursuant to statutes mandating defined benefits be provided
 - Usually applicable to new hires only
 - No additional reporting required
- Increase mandatory contributions to a DB plan
 - Can apply for current and future employees
 - Subject to statutory limits in plans governed by statute
- Add a cash balance feature for new hires to existing DB plan
 - If employees “cash out” at retirement, longevity risk avoided
 - No additional reporting required because it’s a DB provision



DROP - Deferred Retirement Option Plan

- Legal framework established via passage of Act 44 in 2009 (which amended Act 205).
- Eligible participants sign a binding agreement to enter the DROP and to cease employment after completing a specified additional period of service not to exceed the maximum allowed under the plan (can be up to 5 years)
- Monthly benefit calculated at DROP entry is credited to the participant's DROP account, with interest at the rate earned by the plan (but no less than 0% or more than 4.5% annually)
- At DROP exit, monthly payments are issued to the retiree directly and the DROP account is distributed as a lump sum.
- DROP participants are not included in the MMO, do not make employee contributions and no state aid is received for them.



Don't forget the Actuarial Study!

- Required by Act 205
- Prior to adoption of plan change
- Illustrates impact on plan funding levels and employer contribution requirements (MMOs)
- Projection studies can illustrate long-term impact
 - Helpful when a change is proposed for new hires only



Police Department Regionalization

Pension Considerations

- Negotiating pension benefits with the union
- Preparing and adopting a pension plan document
- Naming a Chief Administrative Officer for the pension plan
- Selecting an actuary, investment manager, custodian and other service providers for the plan
- Incorporating major issues surrounding the pension into the Intergovernmental Cooperation Agreement (ICA), including handling of future withdrawal or addition of municipalities
- Notifying the Auditor General's Municipal Pension Reporting Program of the new plan
 - Obtaining online login for use in filing AG-385 and Act 205 forms for the plan



Potential Challenges When Merging Plans

- Establishing a benefit structure that doesn't diminish benefits of officers transferring to the new regional plan
- Difference in funding levels of municipalities' plans
- Handling existing liabilities of the plans
- Deciding how pension obligations will be handled if the regional department disbands

Purchase of Service Arrangements

- Different than regionalization
- A municipality disbands its police force and enters an ICA with another municipality for provision of police services.
- Act 600 allows that the ICA may provide for transfer of service credits (and assets) of an officer of the disbanded force who is hired by the contracted force within 6 months.



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Proposed Legislation

Ad Hoc Postretirement Adjustment for Municipal Police and Firefighters

- House Bill 1379
 - Status: Referred to Local Government Committee on June 12, 2023
- Senate Bill 854
 - Status: First consideration Oct. 17, 2023; Re-referred to Appropriations Committee on October 23, 2023



Summary

- Amends Act 147 of 1988 (Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act)
- Amount of adjustment based on length of retirement



Service Buyback for Local Police Officers

- Senate Bill 464
 - Status: First Consideration April 25
Re-referred to Appropriations Committee May 1

Summary

- Permits full-time officers who are vested in their current employer's pension plan to purchase prior full-time or part-time police service with any PA department
- Officers of cities (other than Philadelphia), boroughs, towns, townships and regional departments are eligible
- "Purchase price" calculated as is military service buyback under Act 600
- Total full-time, part-time and military service purchased by an officer cannot exceed five years



- Service which entitles an officer to a pension from a previous employer's plan may not be purchased.
- Municipalities would be required to amend their police pension plans to permit this service purchase.

Actuarial Note¹

- If three years of service is purchased right after vesting
 - The plan will experience a loss of approximately 14% of the officer's pay at the time of purchase.
 - The officer's payment will cover 68% of the actuarial cost.
- If three years is purchased just prior to retirement
 - The plan will incur a loss of approx. 25% of the officer's pay.
 - The officer's payment will cover 55% of the actuarial cost

¹ Prepared by Foster & Foster for the Independent Fiscal Office on May 17, 2023



Tips, Takeaways, and Reminders

- Deposit State aid within 30 days of receipt into the pension plan (or use it to reimburse the general fund for deposits made throughout the year).
- Obtain a cost study prior to making any changes to the plan.
- Complete the AG385 with wages and contributions for all eligible employees by 3/31.
- Keep your actuary apprised of demographic changes
- Review and approve all Domestic Relations Orders of your employees who will collect a pension prior to approval by the Court.
- Ensure employee contributions to the plans are withheld from the proper pay components and pay attention to whether the contributions are pre-tax or post-tax.
- Maintain pay and employee contributions documentation “forever”.
- Keep your plan document up to date.
- Pay the MMOs in full by December 31st each year. Late payments will require interest.



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