



The Pennsylvania Municipal League
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The Pennsylvania State Association of Township Commissioners
President – John Kuntzelman, Commissioner, East Pennsboro Township

PML / PSATC
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**PA Municipal League and
PA State Association of Township Commissioners**

**Testimony before the Joint House and Senate Local Government Committees
Regarding the Blake/Greiner Municipal Pension Reform Proposal**

Presented by Amy Sturges, Director of Governmental Affairs

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Chairwoman Harper, Chairman Wagner, Chairman Freeman, Chairman Blake and members of the House and Senate Local Government Committees, good morning. I am Amy Sturges, Director of Governmental Affairs for the PA Municipal League and the PA State Association of Township Commissioners.

Thank you for holding today's joint hearing to begin discussing the new municipal pension proposal before us today. Achieving true pension reform for public-safety pensions has been a priority for PML and PSATC since 2010. Together, the two organizations represent over 150 urban and full-service communities employing full-time police and fire personnel, in addition to providing the gamut of municipal services to their residents.

Our goal of true municipal pension reform means attaining *affordable, predictable and sustainable* public-safety pensions for all communities and public-safety employees. We believe the proposal before us today moves us closer to that goal. We sincerely appreciate the bi-partisan and bi-cameral effort that is behind this legislation. And we look forward to working with the sponsors, and all of you, to move this proposal forward to the final destination of the Governor's desk.

My testimony today is general, commenting on the overall concepts of the proposal. Following my written testimony are a few technical comments for future consideration. I want to be clear that my comments today and my written testimony are qualified in terms of our understanding of the draft proposal. Subsequent changes to the draft could change our current position.

Achieving affordable, predictable and sustainable public-safety pensions requires a reduction or elimination of the impact of Act 111 collective bargaining on pension benefits. It also means reducing and standardizing the pension benefits of new hires. Although not as we initially envisioned, this proposal meets those requirements.

Limitation on Act 111 Collective Bargaining:

Bargaining over pension benefits creates enormous uncertainty and pressure on employers concerning future benefits and their cost. An Act 111 award or agreement that enhances pension benefits will impact cost for the lifetime of the employee and his or her beneficiaries. In fact, an Act 111 arbitrator has more influence on future costs than a municipality's own elected officials. Act 111 has its place in employee/employer

relations. In order for pension benefits to be predictable, however, the impact of Act 111 must be curtailed.

This proposal limits Act 111's influence in several ways. First, if a current plan is 90% funded or better, the status quo will continue. However, if a contemplated change in benefits will cause a drop in funding level below 90%, that change is prohibited. This provision allows Act 111 to impact only the healthiest plans and limits that impact substantially. Second, for current plans between 80% and 90% funded, the proposal takes the bargaining of pension benefits off the table until funding levels improve to 90%. And third, plans utilizing bond funds and new standard plans are relieved of Act 111's influence for 30 years coinciding with repayment of the bond. These provisions establish predictability, affordability and sustainability from the outset for both existing and new plans.

Reduced and Standardized Plans for New Hires:

The proposal provides a uniform pension tier – the standard plan – for new hires across municipalities; this has a number of benefits. The new benefit tier exists within the current pension plans, as opposed to being a statewide plan, this allows plan management to remain local. Municipalities with current plans funded at less than 80% for two consecutive Act 205 valuation periods (four years) would be required to start a new benefit tier for new public-safety personnel. The new plan remains a defined benefit plan. Continuation of the defined benefit structure is contrary to what PML and PSATC have supported in prior sessions. It is an outdated pension concept largely unused today in the private sector. The employer is responsible for paying the defined pension benefit for the life of the employee, which in the case of public-safety officers,

could be longer than the years worked because of the low retirement age. Furthermore, the employer is wholly responsible for any risk associated with pension investment losses.

That said, we can support continuing the defined benefit pension for new hires, as long as the benefits are reduced; Act 111 is restricted; and a cost savings is realized. Without the benefit of an actuarial study, we can tentatively say we believe the standard plan will constitute reform.

Our understanding of the standard plan finds a reduction in benefit levels for new hires in several ways:

- It defines compensation as base salary only. This change eliminates the “spiking” of salary in the final months of work which can result in an inflated pension benefit.
- It caps overtime at 10% of an employee’s base salary. This also reduces spiking.
- It looks at the last 60 months of employment in calculating final average salary rather than the last 36 months. This provides a longer, more inclusive, salary level in determining the final pension payment.
- It requires both a mandatory employee and employer contribution. This is important to the overall sustained health of a plan. Employers are responsible for the annual municipal obligation which fluctuates based on several factors including investment losses. Employees are required to make a 6% or 8% percent of salary contribution depending on whether they receive Social Security.
- It reduces the final monthly pension benefit currently at a minimum of 50% of final average salary. This is a very important provision in achieving affordable

pensions because the defined pension benefit is set for the life of the employee and includes a survivor benefit. This proposal also introduces a multiplier to the pension calculation – years of service x final average salary x .0125. The multiplier is a new concept in municipal pension calculations. It must remain low resulting in a reduced benefit, in order for PML and PSATC to support.

- It prohibits new hires from having a Deferred Retirement Option Plan or DROP benefit which has been more costly to employers than originally anticipated, especially when awarded as part of Act 111 collective bargaining.

The standard plan does change retirement eligibility or superannuation age. The proposal allows retirement eligibility at *any* age when 25 years of service is attained. Currently, under Act 600, employees are eligible *after* 25 years of service *and* at 50 to 55 years of age. Under the Third Class City Code, employees are eligible for retirement with at least 20 years of service *and* age 50, if age has been negotiated under Act 111. Eliminating the age requirement will result in a cost to boroughs and townships because there will be a longer period of pension payments. In third class cities, the increase of 5 more years of service should result in a savings for employers.

The standard plan also provides employees with a portable pension. They will be able to easily move between employers – something that is impossible now with the variation among plans and no statutorily prescribed way of keeping the employee whole. Under the standard plan, employer contributions made to the plan on behalf of the employee will be transferred to the new employer. Administratively, this will require work for employers, but it is not a prohibitive task. Employers may lose money, however, when

employees move early in their careers before the first employer has seen a financial return on its training investment.

The vesting timeframe is decreased to 10 years under the standard plan. Currently, vesting occurs at 12 years. We do not anticipate this to create a great cost to employers, but would not want to see it reduced further.

Sustainability Provisions:

The proposal includes a number of sustainability provisions that were part of the Auditor General's 2015 Municipal Pension Task Force Report to Governor Wolf. We support these measures which apply to all public-safety plans as they are good government actions.

The most significant sustainability provision requires the assumed rate of return on investment to be reduced. In many communities, the assumed rate of return is inflated to control the annual minimum municipal obligation or MMO. This is the annual mandatory employer payment necessary to keep a plan actuarially sound. The proposal allows the assumed rate of return to be reduced over 10 years. This will help control the costs associated with reporting a more realistic rate of return on investment. The PMRS rate plus 1% is used as the goal. We agree with this rate as PMRS is regarded for its conservative outlook and resulting healthy plans.

Another important sustainability provision limits plan changes if they would result in a plan's funding dropping below 80%. This ties into the Act 111 limitations addressed

earlier in my testimony and again keeps Act 111 from having too costly an impact on a plan.

Severely Distressed Pension Plans:

Plans currently under-funded by 50% or more need significant remediation. We support the requirement in this proposal that severely distressed plans be placed under the administration of PMRS. It is important to make sure that distressed plans moving under PMRS also have 10 years to reduce their assumed rate of return. Otherwise, an immediate drop to the PMRS rate will result in a financially unmanageable MMO. We do not see this provision in the proposal and request its addition. Finally, we defer to PMRS for guidance on the language to move the severely distressed plans under its care.

Municipal Pension Bond:

The addition of a municipal pension bond is a new and beneficial concept to the pension reform discussion. We support the inclusion of a bond as a funding mechanism to allow municipalities to pay down some or all of their unfunded liability at once. This will immediately improve the health of current plans and reduce annual MMO payments. The Act 205 municipal pension state aid funds are an appropriate source for municipalities to borrow against. Some municipalities may be reluctant to borrow against their state aid payments, however. Those with plans close to the 80% funded threshold that triggers the borrowing could take steps to bring funding levels up and avoid the borrowing. It is our opinion that borrowing against the Act 205 state aid will result in greater savings in the long term by making plans more affordable and healthier in the short term.

To conclude, we find this proposal promising in achieving our goal of *affordable, predictable and sustainable* public-safety pensions. There are a number of technical issues that need to be addressed, but overall the concepts of limiting Act 111's influence on pension benefits and establishing a new and reduced benefit tier for new hires will go a long way toward true reform. We offer our assistance and request participation in future discussions to generate a final piece of legislation for consideration by the General Assembly. Again, thank you for your time this morning and thank you to the drafters and sponsors for their efforts to date.

Items for consideration and clarification:

Following is a list of items we have identified as needing further refinement. We do not intend for this list to be all-inclusive.

- Section 103: Definitions:
 - The term “non-uniformed” on page 5; line 23 and on page 7; lines 21-22 should be removed.
 - The definitions of “municipality” and “employer” should include home rule municipalities.
 - “Interest” is defined at a rate of 4%. Does this correspond to interest payments noted on page 9; lines 19 and 23 and page 12; line 23?
 - A definition for full-time police officer and fire fighter should be added.

- Under the definition of “final average salary,” the word “qualified” should be added before employment to cover a gap in time when an employee does not receive full salary.
- Under the definition of “member contributions,” at line 27, “determination date” should be changed to “termination date.”

- Section 502: Benefit Options:
 - The term “annuity” is not currently used in municipal public-safety pension law. We need to be sure all are clear on the terminology. Is it simply the benefit? Additionally, the words benefit, allowance, and lump sum are also used at various times to describe the pension payment.
 - Page 10; lines 12-14 mentions “annuity options.” This needs to be clarified. Traditionally, a defined benefit plan would not offer payment options – a pensioner receives a set monthly pension check for life.
 - Page 10; lines 16-21 should clarify the timing of pension payments.
 - The social security provision on page 10; lines 22-24 needs further clarification as to its intent.
 - The partial retirement option at page 11; lines 1-9 is a new concept and a new benefit, as is the early retirement benefit at page 11; lines 17-19. Both have the potential to negatively impact the financial health of a plan.

- Section 503: Election Upon Termination of Service:
 - How is the reduced pension benefit calculated for early retirement?

- This is a new benefit has the potential to negatively impact the financial health of a plan.

- Section 701: Work-related Disability:
 - 701 (b) (3): References a savings account which does not exist in a defined benefit structure.

- Section 702: Disability Insurance:
 - Subsection (1) - Authorizes the purchase of disability insurance for employees permanently unable to return to work performing the duties of a police officer or fire fighter. However, subsection (3) says the insurance benefit should be paid until the employee is able to return to work as a police officer or firefighter... This is contradictory.
 - Additionally, the “may provide” language implies this is a benefit that can be bargained. We suggest that there be clarification that the purchase of insurance is at the employer’s discretion.

- Section 901 (1) and (2): Assumed Actuarial Rate of Return:
 - Subsections (b) and (c) are out of order assuming (b) is referring to plans that have reduced to the PRMS + 1% level.
 - There should be an option to reduce the rate quicker than 10 years.
 - Once a plan reaches the PMRS +1% rate, it should be allowed to continue at that rate for future calculations. Subsection (b) seems to imply the rate would drop again to the PMRS rate.

- Subsection (b) mentions plans established under Act 205. Pension plans are not established under Act 205.
- Section 903 (c): Mandatory Minimum Obligation:
 - If a municipality has pledged its future state aid through the bond issue, its Act 205 money will not be available to be withheld.
- A voluntary 457 Plan should be considered for employees in the new standard plan. This should be solely at the option of the employer and if implemented the only contributions coming from employees who wish to participate.

PML is happy to further clarify any of the above bullet points.