MINUTES
Charter Revision Commission
April 29, 2014

CALL TO ORDER
Chairman Suzanne Burr Monaco called the Charter Revision meeting to order at 7:00 p.m. at the Town Hall, Nichols Room, Trumbull, Connecticut. Members introduced themselves for identification for Ch17. All present joined in the Pledge of Allegiance.

PRESENT
Suzanne Burr Monaco, Chairman
Dan Portanoa, Vice Chairman
Adam Maiocco, Secretary
Ken Martin
Daniel Shamas
Vincent Monaco, Town Attorney
Also, Maria Pires and John Ponzio

Review minutes of 4/22/14 meeting. One correction in opening paragraph changing "budget" to "Charter Revision," moved by Dan Portanova, seconded by Dan Shamas, voted to approve the minutes as corrected.

The Chair opened with comments that the Commission tonight would begin the process of prioritizing the revisions to be made to the Charter.

The Chair introduced Maria Pires and John Ponzio, who were present to provide information regarding the proposed pension revision.

M. Pires began by explaining the ARC – an Actuarial Required Valuation to meet future liabilities of the plan, based on contributions by employees and employer, with an assumed rate of return on investments and mortality tables. As of 11/2013, the Town pension was 32.5% funded and the police pension was 74.1% funded.

J. Ponzio explained that when the present administration took office, the police pension was more funded than the Town pension. As a result of ARC funding beginning with the first year of the present administration, the Town pension has grown from 27%, based on a 3-year phase-in to achieve the ARC. The police pension was not worked as hard because it was higher funded. The cost of implementation for the first year would be approximately $1M, which could be similarly phased in over a 3-year period, with $200K-$300K per year subsequently to fully fund the ARC. This contribution would get the police pension fully funded- it is approximately $900,000 short. The Town is presently funding at 100% of the ARC.

There are presently 3 pension plans: 1) Town; 2) Police, and; 3) 401A plan for non-union employees. The 401a plan requires a 5-7% contribution. The 401A plan presently covers exempt employees. New union employees to be hired will be covered under the 401A plan. The 401A plan is a Defined Contribution Plan, rather than the present Defined Benefit Plan. One of the benefits of the 401A plan is that once the 5-7% contribution has been paid by the Town, the Town's obligation has been met.

Actuaries have presented a 10-year plan based upon Town contribution and employee contribution. Said documents are incorporated as an exhibit. The average investment return is set at 7.5%, based on a diversified investment strategy, taking mortality and employee turnover into consideration. The funding comes out of the operating budget. Using the 10-year plan, the Town pension will be 52% funded. The plan has approximately $25M in it and is currently generating a positive return.

An opt-out provision was suggested for consideration, for emergency economic situations. This may require a 2/3 vote by the Town Council- maybe more- and may require an annual vote. It would not be a simple carve-out.

It is the present administration's commitment to continue funding to the ARC. The purpose of mandated funding would be to guarantee that future administrations continue to fund to the ARC. This would prevent future administrations from neglecting said funding, thus causing the funds to be depleted. The Town is legally obligated to make the pension payments. If funds were not available, the taxpayers could be hit with a large tax to cover the funding if the funds were not available. The unfunded pension plan is the number one complaint by the rating agencies. The progress made in the Town's pension contributed to an upgrade by S&P from AA to AA+. It took 5 years to upgrade from AA to AA+. It will take time reach AAA status. S&P is on board. We want to get Moody's on board as well.

Mr. Ponzio was asked to determine the number of towns in Fairfield County which mandate funding to the ARC. There being no further questions, Mr. Ponzio and Ms. Pires were excused.

The discussion ensued, with a review of the following topics:

1. How the revisions are implemented. The Commission is charged with presenting the areas of revisions to the Town Council who will decide the issues.
2. Discussion of the traffic engineering, Civil Service Commission, and Arts Commission. The Commission agreed that the previously contemplated revisions to the Charter relative to the Civil Service and Arts Commissions will not be made.
3. The areas the Commission will finally review for possible revision:
    a. Mandate of Pension Funding to the ARC. Discussion of possibility of Town Council having the right to "opt-out" for a particular year in the event of a significant economic situation. This could be detrimental as it could be used at any given year. The opt-out provision should not be used as a political football. The Commission agrees that it makes fiscal sense to fund to the ARC. Reiterated that in the event of a deficit at any given time, the Town is legally obligated to pay, which could create a huge tax implication.
    b. 4-year term for the First Selectman, Town Clerk, and Town Treasurer, which would not become effective until the 2017 election.
    c. 4-year Board of Education term beginning in 2015, with 3 members serving a 2-year term and 4 members serving a 4-year term. All elections thereafter would be for 4-year terms.
    d. Revising the line of succession for the First Selectman to Council Chair, then Town Treasurer, in accordance with the Home Rule Act.
    e. Definition, language, "housekeeping" items to include:
        i. Increasing the purchasing amount from $1,000 to $5,000;
        ii. Deleting "private" hearings from the Ethics Commission section;
        iii. Adding the word "non-privileged" regarding the posting of materials to ensure that supplemental materials from Executive Session are not made public;
        iv. Replacing "business days" with "calendar days" and keeping all days consistent;
        v. Changing the budget voting requirements of the Town Council from 2/3 of the entire membership to a majority of the members present;
        vi. Changing the date of appointments for positions to become effective on publication rather than 15 days later;
        vii. Notice provisions at 48 hours;

Each member was requested to provide their top four, and the possibility of consolidating any of the above.

The meeting was adjourned by motion of D. Portanova, seconded by D. Shamas and unanimous consent at 8:30PM.

Respectfully submitted,
Nancy Milewski
Nancy Milewski

POINTS FOR THE CHARTER REVISION

1. What is the ARC?

   Actuarial Required Valuation to meet future liabilities of plan based on contributions by employees and employer, assumed rate of return on our investments and mortality tables,

   As of November 2013-Town 32.5% funded and Police 74.1% funded

2. Cost of implementation for the first year is $1.0 million mainly to fund the Police and the DC plan as we are already contributing the ARC to the Town DB plan.

   Consider 3 year implementation to reach the ARC in the Police pension similarly to what we did with the Town's since it's currently 74.1% funded

3. Benefits of adoption?
   - Bond rating agencies-Bonding rating agencies have criticized our current funding rates but realized we have made progress in the Town's pension, contributing the ARC starting with FYE 2014. This contributed to an upgrade by S&P from AA to AA+.
   - Union relations-That has always been a concern by the unions, can be used as a bargaining tool.
   - Govt accounting standards are leaning to full funding plan, given the issue Detroit
   - Reduces the variable in calculating the ARC
   - Town's exposures ends once the Town makes it's 5-7% contribution
   - Portability by the employee

TOWN OF TRUMBULL
PROJECTED SUMMARY
PREPARED FOR DISCUSSION ONLY
BY BPS&M ACTUARIES

Baseline Scenario - Assumed Rate of Return
(7.50% for Town Plan, 8.00% for Police Plan)

	Fiscal Year Ending 6/30/2015	Fiscal Year Ending 6/30/2016	Fiscal Year Ending 6/30/2017	Fiscal Year Ending 6/30/2018	Fiscal Year Ending 6/30/2019	Fiscal Year Ending 6/30/2020	Fiscal Year Ending 6/30/2021	Fiscal Year Ending 6/30/2022	Fiscal Year Ending 6/30/2023	Fiscal Year Ending 6/30/2024
Projected ARC - Town	4,639,000	4,602,000	4,596,000	4,639,000	4,688,000	4,741,000	4,795,000	4,855,000	4,916,000	4,979,000
Projected ARC - Police	2,963,000	2,919,000	2,872,000	2,843,000	2,849,000	2,859,000	2,871,000	2,886,000	2,906,000	2,928,000
Projected DC Plan Contributions Assuming 1 Million in New Payroll Each Year	60,000	122,000	187,000	254,000	324,000	397,000	473,000	552,000	634,000	719,000
Total Projected Cost Assuming 1 Million in New Payroll Each Year	**7,662,000**	**7,643,000**	**7,655,000**	**7,736,000**	**7,861,000**	**7,997,000**	**8,139,000**	**8,293,000**	**8,456,000**	**8,626,000**

2014-15 BUDGET	
Town	4,693,000
Police	2,050,000
DC Plan	88,000
TOTAL 2014-15 BUDGET	**6,831,000**
Difference	**831,000**

	6/30/2015	6/30/2016	6/30/2017	6/30/2018	6/30/2019	6/30/2020	6/30/2021	6/30/2022	6/30/2023	6/30/2024
Projected Funded Percent-Town	**33%**	**37%**	**39%**	**41%**	**43%**	**45%**	**47%**	**48%**	**50%**	**52%**
Projected Funded Percent-Police	**71%**	**74%**	**77%**	**79%**	**80%**	**82%**	**83%**	**85%**	**86%**	**87%**

[redacted]

BPS&M

Bryan, Pendleton, Swats & McAllister, LLC
A Wells Fargo Company

April 25, 2014

Ms. Maria Pires
Director of Finance
Town of Trumbull
5866 Main Street
Trumbull, CT 06611

Town of Trumbull Retirement Plan and Town of Trumbull Police Retirement Income Plan—Projected Annual Required Contribution for 2014-15 Fiscal Year and Subsequent Fiscal Years

Dear Maria:

As requested, we have calculated the projected Annual Required Contribution ("ARC") for the Town of Trumbull Retirement Plan and the Town of Trumbull Police Retirement Income Plan for the fiscal year beginning July 1, 2014 and ending June 30, 2015 and the next nine fiscal years. The projections are shown in the attached exhibit.

Data, Assumptions, and Methods

Town of Trumbull Retirement Plan
In determining the expected market value of assets on June 30, 2014, we began with the fair market value of assets as of March 31, 2014 of $26,536,670. This market value was adjusted for expected cash flows for the period from April 1, 2014 through June 30, 2014.

Per the asset statement we received as of March 31, 2014, we assumed the Town has already made all of the contributions for the 2013-14 fiscal year and no additional contributions will be made. Additionally, expected benefit payments, administrative expenses, and employee contributions over the three month period were taken into consideration. Finally, an expected annual return on assets of 7.50% was assumed.

The participant data, actuarial assumptions, and methods used to develop the ARC are the same as those used in the July 1, 2012 Actuarial Valuation Report for the Town of Trumbull Retirement Plan dated March 5, 2013.

Town of Trumbull Police Retirement Income Plan
In determining the expected market value of assets on June 30, 2014, we began with the fair market value of assets as of December 31, 2013 of $47,345,980. This market value was adjusted for expected cash flows for the period from January 1, 2014 through June 30, 2014.

We assumed the Town will contribute $850,000 during the remainder of the 2013-14 fiscal year. Additionally, expected benefit payments and employee contributions over the six month period were taken into consideration. Finally, an expected annual return on assets of 8.00% was assumed.

The participant data, actuarial assumptions, and methods used to develop the ARC are the same as those used in the July 1, 2012 Actuarial Valuation Report for the Town of Trumbull Police Retirement Income Plan dated March 5, 2013.

Defined Contribution Plan
We assumed that the Town will contribute 6.00% of eligible payroll to the defined contribution plan. Annual salary increases of 4.00% were also assumed. The DC Plan contribution projections are shown using a $2 million new eligible payroll assumption for each year and a $5 million new eligible payroll assumption for each year.

Other
For sensitivity results, we analyzed three scenarios: a baseline scenario using the assumed rate of return for each plan, a "worst case" scenario using the approximate 5th percentile return (0.70% annual average return) from the Wells Fargo Capital Assumptions Model, and a "best case" scenario using the approximate 95th percentile return (13.80% annual average return) from the Wells Fargo Capital Assumptions Model.

Actuarial Certification and Professional Qualifications

The actuarial calculations included on the attached exhibit are built on deterministic actuarial modeling, making a single determination of liabilities and costs. Further, these actuarial calculations are based on a combination demographic and asset data, as well as assumptions concerning future changes in these data. As such, the actuarial calculations contained herein are an estimate of projected future occurrences. Variances from any of the assumptions will result in different results, which may be materially different from those shown in this letter report.

This letter report provides actuarial advice and does not constitute legal, accounting, tax, or investment advice.

This letter report has been prepared under the supervision of James M. DeGrandis Jr. and Brian A. Hartman, both of whom are Enrolled Actuaries and consulting actuaries with Bryan, Pendleton, Swats and McAllister, LLC who have met the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions herein. To the best of our knowledge, this letter report has been prepared in accordance with generally accepted actuarial standards including the overall appropriateness of the analysis, assumptions, and results and conforms to appropriate Standards of Practice as promulgated from time to time by the Actuarial Standards Board, which standards form the basis for the actuarial report. We are not aware of any direct or material indirect financial interest or relationship, including investment management or other services that could create, or appear to create, a conflict of interest that would impair the objectivity of our work.

Please let us know if you have any questions, or if you need any additional information, regarding these calculations.

Sincerely,

Brian A. Hartman, FSA, EA
Consulting Actuary

James M. DeGrandis, EA, CEBS
Consulting Actuary / Principal

Town of Trumbull Retirement Plan and
Town of Trumbull Police Retirement Income Plan
Projection Summary

Baseline Scenario - Assumed Rate of Return
(7.50% for Town Plan, 8.00% for Police Plan)

	Fiscal Year Ending 06/30/2015	Fiscal Year Ending 06/30/2016	Fiscal Year Ending 06/30/2017	Fiscal Year Ending 06/30/2018	Fiscal Year Ending 06/30/2019	Fiscal Year Ending 06/30/2020	Fiscal Year Ending 06/30/2021	Fiscal Year Ending 06/30/2022	Fiscal Year Ending 06/30/2023	Fiscal Year Ending 06/30/2024
Projected ARC - Town	4,639,000	4,602,000	4,596,000	4,639,000	4,688,000	4,741,000	4,795,000	4,855,000	4,916,000	4,979,000
Projected ARC - Police	2,963,000	2,919,000	2,872,000	2,843,000	2,849,000	2,859,000	2,871,000	2,886,000	2,906,000	2,928,000
Projected DC Plan Contributions Assuming 2 Million in New Payroll Each Year	120,000	245,000	375,000	510,000	650,000	796,000	948,000	1,106,000	1,270,000	1,441,000
Projected DC Plan Contributions Assuming 5 Million in New Payroll Each Year	300,000	612,000	936,000	1,273,000	1,624,000	1,989,000	2,369,000	2,764,000	3,175,000	3,602,000
Total Projected Cost Assuming 2 Million in New Payroll Each Year	7,722,000	7,766,000	7,843,000	7,992,000	8,187,000	8,396,000	8,614,000	8,847,000	9,092,000	9,348,000
Total Projected Cost Assuming 5 Million in New Payroll Each Year	7,902,000	8,133,000	8,404,000	8,755,000	9,161,000	9,589,000	10,035,000	10,505,000	10,997,000	11,509,000

Worst Case Scenario - 5th Percentile Rate of Return
(0.70% for both Town and Police Plans)

	Fiscal Year Ending 06/30/2015	Fiscal Year Ending 06/30/2016	Fiscal Year Ending 06/30/2017	Fiscal Year Ending 06/30/2018	Fiscal Year Ending 06/30/2019	Fiscal Year Ending 06/30/2020	Fiscal Year Ending 06/30/2021	Fiscal Year Ending 06/30/2022	Fiscal Year Ending 06/30/2023	Fiscal Year Ending 06/30/2024
Projected ARC - Town	4,639,000	4,652,000	4,755,000	4,964,000	5,182,000	5,407,000	5,638,000	5,877,000	6,123,000	6,376,000
Projected ARC - Police	2,963,000	3,162,000	3,402,000	3,704,000	4,086,000	4,467,000	4,847,000	5,231,000	5,620,000	6,013,000
Projected DC Plan Contributions Assuming 2 Million in New Payroll Each Year	120,000	245,000	375,000	510,000	650,000	796,000	948,000	1,106,000	1,270,000	1,441,000
Projected DC Plan Contributions Assuming 5 Million in New Payroll Each Year	300,000	612,000	936,000	1,273,000	1,624,000	1,989,000	2,369,000	2,764,000	3,175,000	3,602,000
Total Projected Cost Assuming 2 Million in New Payroll Each Year	7,722,000	8,059,000	8,532,000	9,178,000	9,918,000	10,670,000	11,433,000	12,214,000	13,013,000	13,830,000
Total Projected Cost Assuming 5 Million in New Payroll Each Year	7,902,000	8,426,000	9,093,000	9,941,000	10,892,000	11,863,000	12,854,000	13,872,000	14,918,000	15,991,000

Best Case Scenario - 95th Percentile Rate of Return
(13.80% for both Town and Police Plans)

	Fiscal Year Ending 06/30/2015	Fiscal Year Ending 06/30/2016	Fiscal Year Ending 06/30/2017	Fiscal Year Ending 06/30/2018	Fiscal Year Ending 06/30/2019	Fiscal Year Ending 06/30/2020	Fiscal Year Ending 06/30/2021	Fiscal Year Ending 06/30/2022	Fiscal Year Ending 06/30/2023	Fiscal Year Ending 06/30/2024
Projected ARC - Town	4,639,000	4,555,000	4,442,000	4,313,000	4,163,000	3,992,000	3,794,000	3,570,000	3,315,000	3,026,000
Projected ARC - Police	2,963,000	2,726,000	2,427,000	2,080,000	1,697,000	-	-	-	-	-
Projected DC Plan Contributions Assuming 2 Million in New Payroll Each Year	120,000	245,000	375,000	510,000	650,000	796,000	948,000	1,106,000	1,270,000	1,441,000
Projected DC Plan Contributions Assuming 5 Million in New Payroll Each Year	300,000	612,000	936,000	1,273,000	1,624,000	1,989,000	2,369,000	2,764,000	3,175,000	3,602,000
Total Projected Cost Assuming 2 Million in New Payroll Each Year	7,722,000	7,526,000	7,244,000	6,903,000	6,510,000	4,788,000	4,742,000	4,676,000	4,585,000	4,467,000
Total Projected Cost Assuming 5 Million in New Payroll Each Year	7,902,000	7,893,000	7,805,000	7,666,000	7,484,000	5,981,000	6,163,000	6,334,000	6,490,000	6,628,000

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STATE AND LOCAL PENSION PLANS

NUMBER 7, MAY 2008

WHY DON'T SOME STATES AND LOCALITIES PAY THEIR REQUIRED PENSION CONTRIBUTIONS?

*By Alicia H. Munnell, Kelly Haverstick, Jean-Pierre Aubry, and Alex Golub-Sass**

INTRODUCTION

Plan sponsors in the public sector, like their counterparts in the private sector, have accumulated substantial assets to fund their defined benefit pension promises. A snapshot of funding shows that the ratio of assets to liabilities in the public sector is roughly equivalent to that in the private sector. All is not perfect, however. The level of funding among public plans does vary. An earlier *brief* explored the factors that contributed to this variation.[1] One important contributor was the failure of a plan sponsor to make the annual required contribution (ARC). This *brief* peels back one more layer of the onion and explores why some plan sponsors do not pay 100 percent of the ARC.

Section I sets the stage by describing the variation in funding status, the nature of the annual required contribution, and the extent to which plans satisfy this requirement, using a sample of 126 state and local plans from the *Public Fund Survey* and newly collected data. Section II explores possible reasons why some sponsors do not pay the full ARC. It turns out that two thirds of sponsors that fall short are constrained by law in what they can pay. For those not constrained, some of the factors that could be important include lack of funding discipline, governance issues, plan characteristics, and the fiscal pressures facing the state. Section III tests the importance of these factors on contributions.

The key conclusion from this review is the importance of legal restraints in preventing sponsors from making their ARC payments. Laws on the books in

* *Alicia H. Munnell is the Peter F. Drucker Professor of Management Sciences in Boston College's Carroll School of Management and Director of the Center for Retirement Research at Boston College (CRR). Kelly Haverstick is a research economist at the CRR. Jean-Pierre Aubry and Alex Golub-Sass are both research associates at the CRR.* *The authors would like to thank Keith Brainard, Gary Findlay, Norm Jones, Ed Macdonald, and Paul Zorn for helpful comments.*

some places are fundamentally at odds with the financial requirements of funding pension commitments. Most states appear aware of this problem, however, and are in the process of gradually increasing their contribution rates. For those plans that are not constrained, sponsors that use a less rigorous actuarial cost method are less likely to make their annual required contributions. In terms of governance, the composition of the board appears to have no effect. But, at least in our sample, large plans are less likely to satisfy the annual requirement. Finally, plans in states facing fiscal stress are less likely to make their ARC payment.

Assessing Funding Efforts

A sponsor is acting responsibly with regard to funding its pension commitments if it has established an actuarially sound funding plan and is sticking to it. Funding efforts thus are typically assessed in two ways — by the ratio of assets to liabilities and by whether or not the sponsor is paying 100 percent of the annual required contribution (ARC).

Funding Levels

The ratio of assets to the actuarial accrued liability provides a snapshot of a plan's funding status. Figure 1 shows the distribution of funding ratios for the sample of plans included in this analysis. If a state or local government is following an actuarially sound funding plan, a funding ratio of 80 percent is considered adequate, as the funding plan in time should eliminate the shortfall.[2] While 62 percent of plans meet or exceed this 80 percent benchmark, the remaining 38 percent do not. It turns out that many of the plans with low levels of funding are small, so more than three-quarters of the assets in our sample are in plans that are at least 80 percent funded.

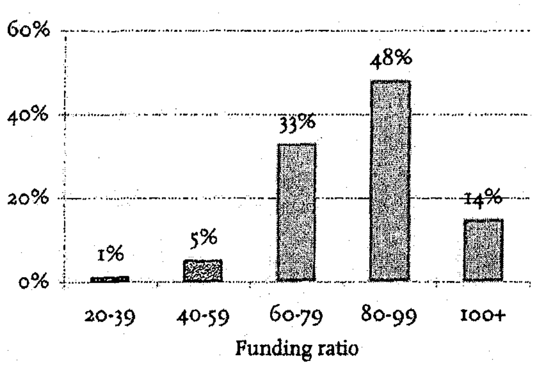
Making the ARC

Whether or not the sponsor is following a sound funding program, as indicated by making its ARC, is the second measure of funding success.[3]

In 1994, the Governmental Accounting Standards Board (GASB) issued Statements No. 25 and 27, which changed the way state and local governments account for pensions and report information and established the ARC as the annual funding target.[4] Employers that pay the full ARC put aside sufficient money to cover the cost of currently accruing benefits as well as a portion of the unfunded liability left over from previous years. Failing to pay the ARC by a material amount means the unfunded liability will likely grow. Comparing a government's actual contributions to the ARC can thus be used to assess the funding efforts of the plan sponsor.

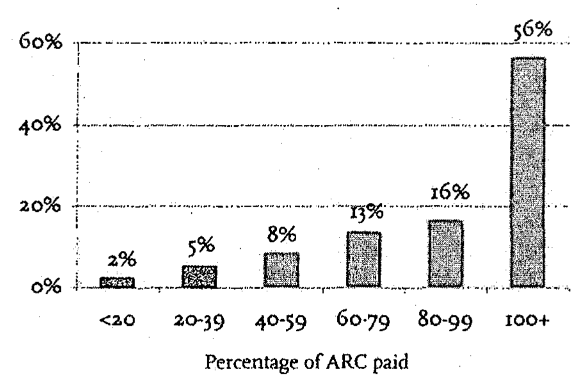
Figure 2 shows that, in 2006, state and local governments paid 100 percent of the ARC for only 56 percent of the plans in our sample. Employers that contribute less than the full ARC could still be setting aside enough money to cover currently accruing benefits. They could even be reducing the plan's unfund-

Figure 1. Distribution of State and Local Plans, by Funding Ratio, 2006



Note: Values do not sum to 100 percent due to rounding.
Source: National Association of State Retirement Administrators and National Council on Teacher Retirement, *Public Fund Survey*, 2006.

Figure 2. Distribution of State and Local Plans, by Percentage of ARC Paid, 2006



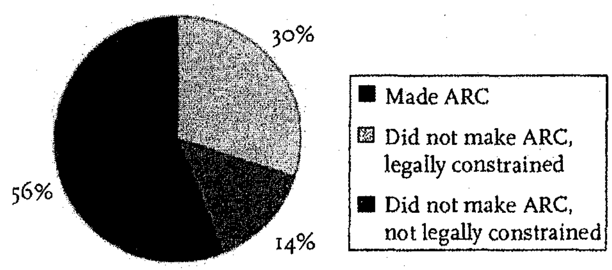
Note: Plans that used the aggregate cost method were coded with 100 percent of ARC paid.
Sources: Authors' calculations from the 2006 PFS and various annual reports.

ed liability from previous years, albeit at a slower pace than the actuary would like. Not making the full ARC payment nevertheless indicates a failure to follow GASB's suggested funding plan. (See Appendix A for a list of plans not making the ARC.) The question is why such a large percentage of plan sponsors are not making the full ARC.

Legal Constraints on Contributions

Experts to whom we spoke suggested that a major reason that some sponsors do not pay the full ARC is that they face legal limitations on how much they can contribute. Indeed, a careful review of the annual reports found that most of the 44 percent of sponsors that did not pay 100 percent of the ARC were legally constrained (see Figure 3).[5]

Figure 3. Distribution of Plans by ARC Payment and Legal Constraint, 2006

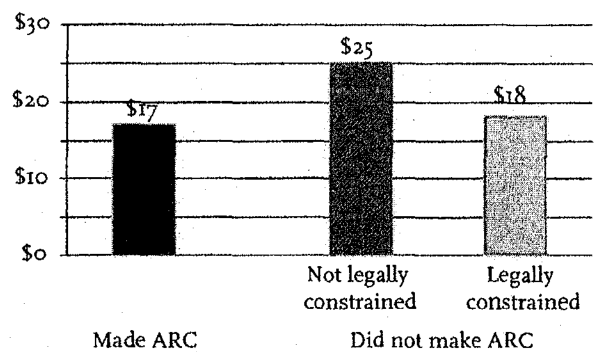


Sources: Authors' calculations from 2006 PFS and various annual reports.

For example, the Kansas public employees' retirement system made only 63.4 percent of its ARC. The reason is that the employer contribution rate is determined by statute and is smaller than the rate recommended by the plan's actuaries. In the case of Kansas, the state legislature is aware of the inadequacy of the statutory contribution rate and has been steadily increasing the legislated rate in an attempt to catch up to the actuarially required contribution level.[6] In fact, most states where funding is legally constrained appear aware of this problem and are in the process of gradually increasing their contribution rates.

In terms of size, the plans of the legally constrained sponsors look like those that paid 100 percent of the ARC. Those that were not legally constrained but still failed to pay the full ARC are noticeably larger (see Figure 4). The question is why these large unconstrained plan sponsors failed to make the full contribution.

Figure 4. Average Assets of State and Local Plans, Billions, 2006



Sources: Authors' calculations from 2006 PFS and various annual reports.

Why Unconstrained Plans May Fail to Make the ARC

Four types of factors might account for the failure of unconstrained plan sponsors to pay 100 percent of the ARC: the sponsor simply lacks the discipline required to stick to a funding regime; the people involved in the governance of the plan could care more about benefit enhancements than funding; the characteristics of the plan make funding difficult; or the state is under fiscal pressure.[7]

Lack of Funding Discipline

Two characteristics would signal that a plan sponsor is not disciplined in its funding effort. The first is that it is new to the game; the second is that it uses a less stringent actuarial costing method, such as the projected unit credit.

Length of funding effort. All else equal, if a sponsor has been making funding contributions for, say, ten years, it indicates a stronger commitment to funding than a sponsor just beginning such a program. Combining data on the normal funding period and the years left to achieve full funding, both of which appear in the annual reports of public sector pension plans, it is possible to estimate how long the sponsor has been engaged in the funding effort. Our hypothesis is that the newer the sponsor to a funding regime, the less committed and the less likely to pay 100 percent of the ARC.

Actuarial method. The choice of actuarial cost method may also indicate the strength of the sponsor's funding commitment. The vast majority of state and local plans uses the entry-age method, but a significant minority uses the Projected Unit Credit (PUC) method. Up to the point of retirement, the entry age method recognizes a larger accumulated pension obligation for active employees than the projected unit credit and generally requires larger annual contributions. Our hypothesis is that sponsors that opt for the cheaper funding regime — namely, the projected unit credit — may be less committed to funding their plans and therefore less likely to make the full annual required contribution.

Governance: Employees/Retirees on the Board

Pension boards can influence a plan's actuarial method and its investment policy, which in turn could affect funding status. The composition of the board may be important. One view is that boards with a lot of workers and retirees could be more interested in benefit expansion or greater cost-of-living adjustments than in funding benefit promises, which could lead to less asset accumulation. Also, to the extent that plan beneficiaries are not financial experts, plan assets may not be well invested. An alternative view is that workers and retirees have more of a stake in the plan's success than outside board members and, therefore, their presence on a board would tend to have a positive impact on a plan's funding status. Earlier studies have shown mixed results.[8] In the following analysis, board composition is represented by the percent of board seats occupied by employees and retirees.

Characteristics of the Plan

Three characteristics of the plan would be expected to affect the likelihood that the sponsor failed to make 100 percent of the ARC — plan size, whether the plan is administered at the state or local level, and the level of employee contributions.

Plan size. As discussed earlier, plans that are unconstrained and not making the full funding contribution are larger than either those that are constrained or those that made 100 percent of their ARC payment. It is unclear why this is the case, but plan size and not making the ARC appear to be positively related.

State administered. One would think state-administered plans would demonstrate better funding discipline and therefore be more likely to make the ARC than locally-administered plans because of access to better management. Therefore, the relationship between failure and state-administration would be negative.

Level of employee contributions. The employee contribution rate could be expected to affect employer contributions for two reasons. The first is that the more paid by the employee, at a given level of benefits, the less required by the employer. So it would be easier for the sponsor to make the required contribution. The second avenue is that high employee contributions are related to not being covered by Social Security, so government employers might feel an increased responsibility to fund their employees' only source of retirement income. Thus, high employee contributions would reduce the likelihood that a sponsor would fail to pay 100 percent of the ARC.

Fiscal Pressure

The final factor that may influence the funding of a public pension plan is the fiscal health of the state. The notion here is that if a state is having fiscal problems, it may meet current non-pension obligations by not making the annual contribution to the pension plan.[9] The measure of fiscal distress in the following analysis is the ratio of a state's debt to its Gross State Product (GSP), which is expected to increase the probability that the sponsor fails to make the full ARC.[10]

The Results

A probit regression was used to estimate the impact of each of the variables discussed above on the probability of a sponsor failing to pay 100 percent of the ARC. Plans that were constrained by legal funding limitations were excluded from the analysis, which reduced the sample size from 126 to 88. The results of the regression are shown in Figure 5 and details are presented in Appendix B. Most of the variables have the expected effect on failing to make the ARC, but many are only marginally significant.

In terms of funding discipline, plans using the projected unit credit costing method are a whopping 35 percentage points more likely to miss their ARC payment. The funding period did not prove to be statistically significant.

With regard to governance, having a large share of the seats held by employees/retirees does not have a statistically significant effect on ARC payments.

Of plan characteristics, only size (measured as being in the top third in terms of assets) has a statistically significant effect. The larger the plan, the more likely it is to fail to meet its ARC payment. State administration and the employee contribution rate appear to have no significant effect on paying the ARC.

Finally, the regression confirms that the fiscal health of the state plays an important role. States with high levels of debt to GSP are more likely to miss their ARC payment than states with less debt. The results show that a one-standard-deviation change in the debt-to-GSP ratio increases the probability of failure by nine percentage points.

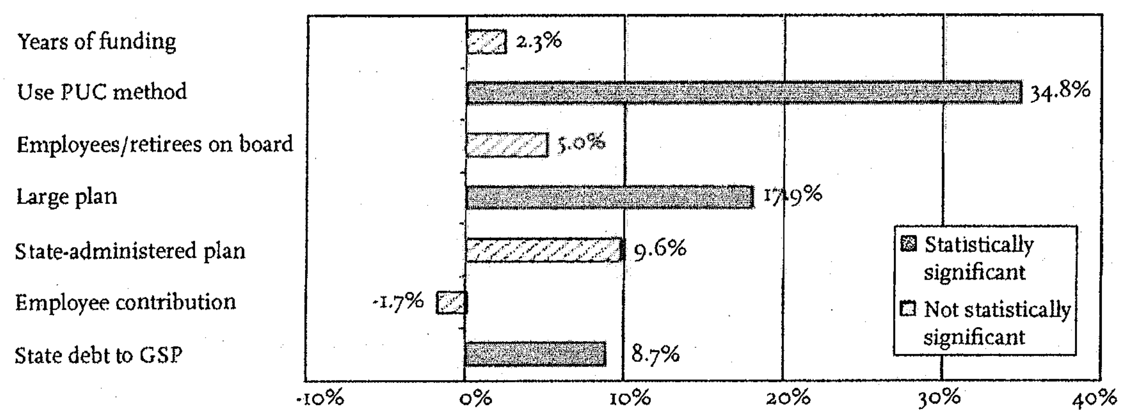
Conclusion

One important factor affecting the funding status of state and local plans is whether the sponsor makes the ARC defined by GASB. Paying the full ARC means that the sponsor is putting aside funds to cover benefits earned in that year plus amortizing any unfunded liability. Plans that fail by a material amount to make their ARC payments will likely see the funding stat~~us of their plans deteriorate~~.

In our sample of 126 plans, an alarming proportion — 44 percent — did not make 100 percent of their ARC in 2006. As it turns out, two thirds of plans failing to meet their ARC were constrained by state legislated contribution limits. Our sense is that states recognize this constraint, and many are trying to raise their contribution limits.

For those not constrained, the failure to cover 100 percent of the ARC is related to a lack of funding discipline, plan size, and the fiscal pressure on state government. The fact that the unconstrained plans that fail to make the ARC are large means that getting them on track is important.

Figure 5. Effect on the Probability of Not Making the ARC, 2006



Note: The results shown are the change in probability of not making the ARC for a one-standard-deviation change from the mean for continuous variables. For dummy variables, the results shown are the change in probability of not making the ARC for a change from 0 to 1.
Sources: Authors' calculations from the 2006 PFS and various annual reports.

APPENDICES

Appendix A. ARCs and Statutory Constraints

Table A1. Plans Statutorily Constrained from Making Their ARC, 2006

Plan name	Employer contribution rate*	Percent ARC made
California TRS	8.25 %	64.00 %
Colorado school employees	10.65	62.00
Colorado municipal	10.50	85.00
Colorado ERS	10.65	58.00
Denver schools	9.48	73.27
Denver ERS	8.50	92.20
Illinois universities	5.90	27.20
Illinois SERS	16.11	31.30
Illinois TRS	7.06	35.80
Iowa PERS	5.75	83.80
Kansas PERS	6.07	63.40
Kentucky ERS	5.89	47.80
Minnesota SERS	4.00	64.88
Maryland PERS	13.01	59.59
Maryland TRS	11.17	91.33
Minnesota PERF	6.00	78.08
St. Paul teachers	8.33	51.06
Duluth TRS	5.79	72.00
Missouri PEERS	5.25	77.50
Missouri TRS	11.50	77.50
Montana PERS	6.90	91.54
Nevada regular employees	10.31	97.00
Nevada police and fire	16.44	91.00
New Mexico TRS	10.15	75.50
North Dakota PERS	4.12	69.00
North Dakota TRS	7.75	63.90
Ohio police and fire	21.75	73.00
Ohio TRS	13.00	88.00
Ohio school employees	14.00	87.00
Oklahoma PERS	10.00	55.30
Oklahoma TRS	13.43	85.80
Oregon PERS	15.20	55.80
City of Austin ERS	9.00	61.80
Texas ERS	6.00	87.20
Texas TRS	5.91	83.00
Vermont SERS	6.48	96.50
Vermont TRS	4.81	44.10
Virginia retirement system	5.27	89.51

* For some plans, there are multiple contribution rates for different employee types within a single plan. An arithmetic average was used when a weighted average based on total employer contributions was incalculable.
Sources: 2006 PFS, various annual reports, and Pew Center on the States (2007).

Table A2. Plans Failing to Make Their ARC That Were Not Statutorily Constrained, 2006

Plan name	Employer contribution rate*	Percent ARC made
Alaska TRS	16.77 %	54.00 %
Alaska PERS	21.00	65.40
Florida RS	6.28	96.00
Chicago TRS	1.86	46.77
Indiana PERF	4.60	92.00
Louisiana SERS	19.10	93.10
Massachusetts SERS	10.60	95.56
Massachusetts TRS	16.17	93.31
Michigan SERS	13.60	73.80
Michigan public schools	7.60	85.72
New Jersey TRS	1.00	8.00
New Jersey PERS	6.00	55.50
New Jersey police and fire	0.20	49.43
Pennsylvania SERS	3.52	35.60
Pennsylvania school employees	3.52	34.00
Washington PERS Plan 1**	1.38	7.00
Washington TRS Plan 1**	2.92	5.00

* For some plans, there are multiple contribution rates for different employee types within a single plan. An arithmetic average was used when a weighted average based on total employer contributions was incalculable.
** Washington PERS and TRS plan 1 were closed to new members as of September 30, 1977.
Sources: 2006 PFS and various annual reports.

Appendix B. Data and Methodology

The sample includes data from the 2006 *Public Fund Survey*, augmented with data from annual reports. For ten plans — Connecticut SERS, Massachusetts SERS, Rhode Island ERS, Wisconsin WRS, Massachusetts Teachers, Minneapolis ERS, New York City Teachers, Ohio Police & Fire, Rhode Island Municipal, and University of California — all the data used in the regression come from annual or actuarial reports. Additionally, for all plans, the percent of ARC paid, total years to amortize unfunded liability, the years remaining to amortize any unfunded liability, and active and retired participants on the board are also from the plans' annual or actuarial reports.[11] Any other plan data missing from the *Public Fund Survey* are also taken from annual or actuarial reports. The state debt is from the U.S. Census Bureau's *State and Local Government Finances: 2004-05* and *2005 State Government Finance Data*. Finally, the data for GSP is from the Bureau of Economic Analysis' *2005 Gross Domestic Product by State*.[12] The summary statistics of these variables are listed in Table B1.

The regression is a probit regression on not making 100 percent of the ARC in 2006. The marginal effect estimates on the probability of not making the ARC are shown in Table B2. One difference between these marginal effects and the effects in the text is that for the four continuous variables — years of funding, percent of the board who are employees or retirees, employee contribution rate and state debt as a percentage of GSP, the text shows the effect of a one-standard-deviation (shown in Table B1) change in the variable while the table below is the effect for a one-unit change in the variable.

Table B1. Summary Statistics of Variables Included in the Regression, 2006

Variable	Mean	Standard deviation	Median
Did not make ARC	0.19	0.40	0
Years of funding	5.82	9.38	0
Use PUC method	0.15	0.36	0
Employees/retirees on board	54.13	24.78	53.59
Large plan	0.34	0.48	0
State-administered plan	0.86	0.35	1
Employee contribution	5.43	2.77	6.00
State debt to GSP	7.27	3.61	6.64

Source: Authors' calculations.

Table B2. Regression Results on Not Making the ARC for State and Local Pension Plans, 2006

Variable	Marginal effect
Years of funding	0.002
	(0.00)
Use PUC method	0.348 **
	(0.16)
Employees/retirees on board	0.002
	(0.00)
Large plan	0.179 *
	(0.09)
State-administered plan	0.096
	(0.08)
Employee contribution	-0.006
	(0.02)
State debt to GSP	0.024 **
	(0.01)
Pseudo R-squared	0.223
Number of observations	88

Notes: Robust standard errors are in parentheses. The marginal effects are significant at the five percent level (**) or ten percent level (*). For continuous variables, the marginal effect is for a one-unit change from the mean. For dummy variables, the marginal effect is for a change from 0 to 1.
Source: Authors' calculations.

Endnotes

1 Munnell, Haverstick, and Aubry (2008).

2 The U.S. GAO (2008) reports that many experts feel that plans that are at least 80 percent funded are healthy.

3 One reviewer argued that the ARC should not be construed as a benchmark, but we believe that GASB guidelines are a reasonable standard against which to judge performance.

4 Statement 25 is entitled "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans." Statement 27 is entitled "Accounting for Pensions by State and Local Governmental Employers." References to the ARC in this *brief* refer to the employer's portion of the annual required contribution — the portion not covered by employee contributions.

5 Other entities also faced legal limitations but they were not binding at this time.

6 In addition to raising the employer contribution rate, Kansas plans on issuing pension obligation bonds, making actuarial changes, and reviewing possible plan design changes in an attempt to fix its underfunding. See Kansas Public Employees Retirement System (2006).

7 One reviewer suggested that the diversion of employer contributions to cover health care costs may explain why some states have failed to pay 100 percent of their ARC.

8 Romano (1993); Coronado, Engen, and Knight (2003); Munnell and Sundén (2001); Harper (2008); Yang and Mitchell (2005); and Hess (2005).

9 The U.S. GAO (1993, 1985) provides examples of states that closed budget gaps by reducing the pension contribution while Chaney, Copley, and Stone (2002) and Bohn and Inman (1996) consider the general effects of balanced budget requirements in states. Since almost all states have some type of balanced budget requirement, this variable was not included in this analysis.

10 The concept of the debt to GSP is similar to the leverage variable used in Davis, Grob, and de Haan (2007) for private employers. This variable is for 2005, as the debt for the District of Columbia in 2006 was not available at the time of the analysis.

11 Since most plans using the aggregate cost actuarial valuation method do not report any amortization period or percentage of ARC paid, plans using this method are assigned a total amortization period of 30 years, the maximum time specified in GASB 27, a remaining amortization period of one year, and 100 percent of ARC paid. This is due to the fact that the annual contribution is calculated as the difference between the present value of future benefits and assets for this actuarial valuation method. For participants on the board, the numbers were separated by active and retired participants where data were available. Otherwise, participants were coded as active.

12 The regression was also run using the 2006 debt to GSP percentages for all states and the 2005 debt to GSP percentage for the District of Columbia, which yielded similar results.

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The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision-makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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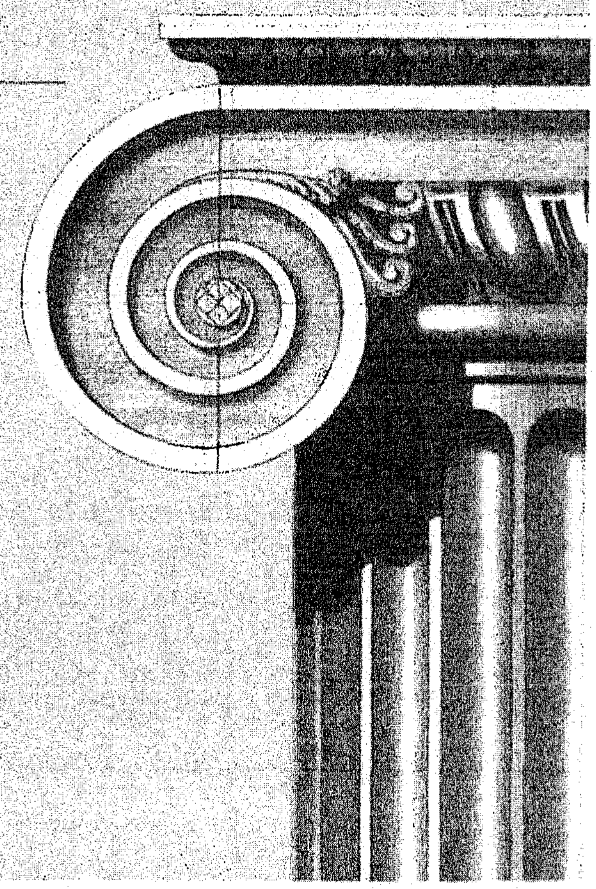
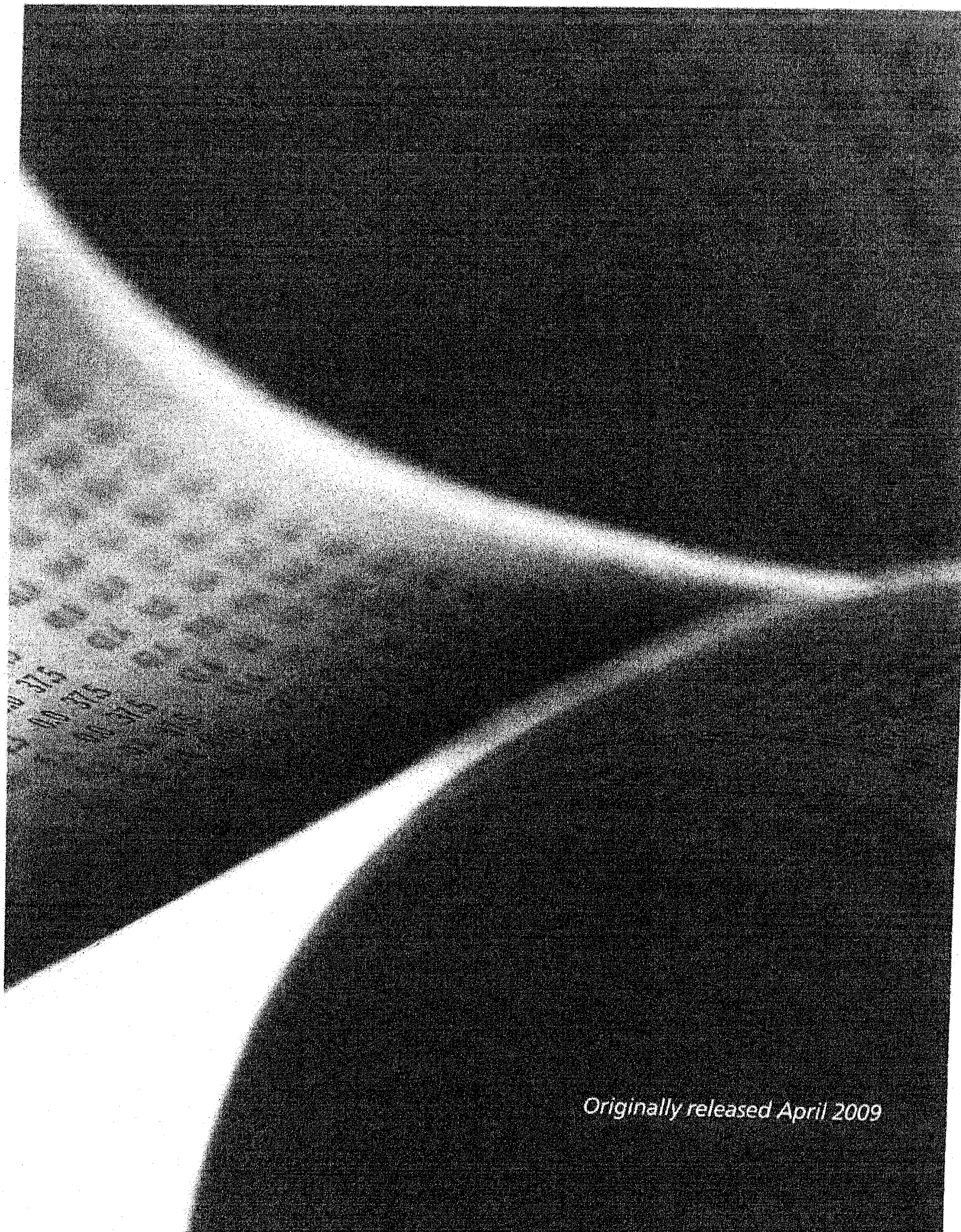
UNIVERSITY OF PITTSBURGH
INSTITUTE OF POLITICS

pensions subcommittee report

What to Do about Municipal Pensions

CONTENTS




Originally released April 2009

Letter from the Subcommittee Cochairs

As cochairs of the Pensions Subcommittee of the University of Pittsburgh Institute of Politics, we are pleased to release the attached report, *What to Do about Municipal Pensions*.

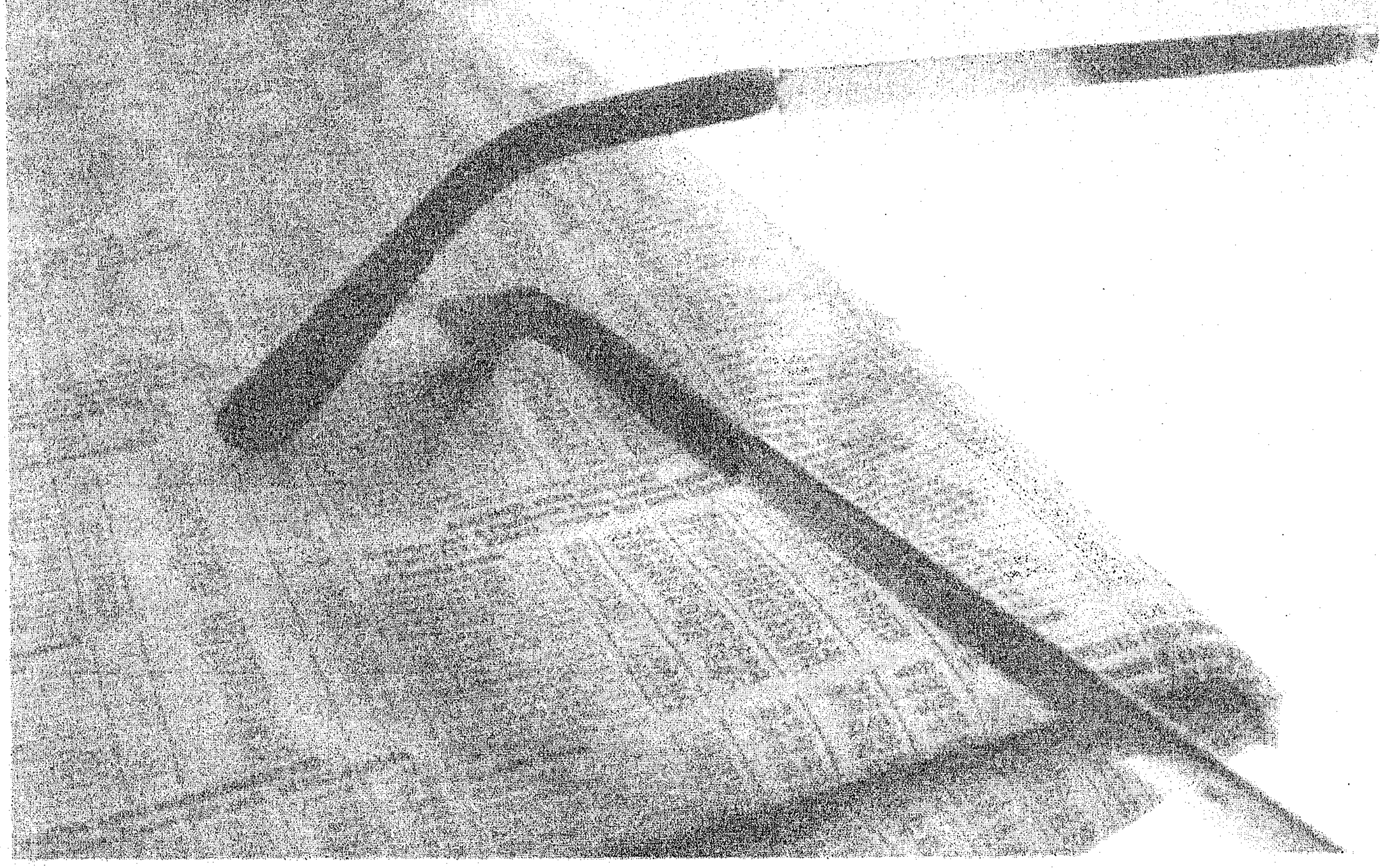
Underfunded municipal pensions were a serious problem in Pennsylvania before the economic downturn of 2008; they now are part of what could become a spreading municipal financial crisis, especially in our cities. Various proposals have been advanced to address this growing concern. The recommendations presented in this report have been agreed upon by a wide variety of stakeholders. While the recommendations' enactment would not solve all our pension problems, the fact that they achieved consensus support from our subcommittee should make them prime candidates for legislative consideration.

Since the initial release of our report early in 2009, various other legislative proposals have been introduced in the State House of Representatives and Senate.

We want to thank the members of our subcommittee, who are identified in this report, for their participation and contributions. We hope that this report will contribute to constructive discussions of policy changes to municipal pensions in Pennsylvania.

Jane Orie
Member,
Pennsylvania Senate

Dan Frankel
Member,
Pennsylvania House of Representatives



Introduction

Even before the precipitous market decline of late 2008, pension obligations were threatening the long-term fiscal stability of many municipalities. Urban centers with declining populations and unfavorable retiree-to-employee ratios—such as Pittsburgh, where pension fund liabilities represent a big chunk of the city's financial woes—have the most serious problems, but underfunded pension plans can be found in dozens of Pennsylvania municipalities of all sizes.

Budgetary pressures, longer life expectancies, and the state's aging demographics have contributed to these pension problems. In addition, some local governments have incurred pension obligations in good economic times that become harder to sustain when the economy stalls and investment returns drop. The status of pension systems as contractual obligations to employees limits options for change; a defined retirement benefit promised to a 25-year-old new hire today becomes an unbreakable financial obligation that could last far into the future.

In response to the growing awareness of municipal pension problems in Pennsylvania, the Fiscal Policy and Governance Committee of the University of Pittsburgh Institute of Politics formed the Pensions Subcommittee to gather information and consider policy options. The subcommittee, cochaired by State Representative Dan Frankel and State Senator Jane Orie, met 10 times from April 2007 through August 2008. Other subcommittee members were:

Henry Beukema, McCune Foundation

Daniel Booker, Reed Smith LLP

Patrick Browne, Pennsylvania State Senate

Richard Caponi, AFSCME, District Council 84

Brian Ellis, Pennsylvania House of Representatives

Angela Williams Foster, University of Pittsburgh

Christina Gabriel, the Heinz Endowments

William "Pat" Getty, Claude Worthington Benedum Foundation

Marva Harris, PNC Bank, retired

Brian Jensen, Pennsylvania Economy League of Southwestern Pennsylvania

Timothy Johnson, Allegheny County Department of Administrative Services

Gerri Kay, the Pittsburgh Foundation, retired

Joseph King, Pittsburgh Fire Fighters IAFF Local No. 1

Bernard Kozlowski, Public Employee Retirement Commission (PERC)

Scott Kunka, City of Pittsburgh Department of Finance

Michael Lamb, City of Pittsburgh Controller's Office

Jeffrey Lewis, Heinz Family Philanthropies

Bill Lickert, Teamsters Local 205

Marick Masters, University of Pittsburgh

David Matter, Oxford Development Company

David Miller, University of Pittsburgh

Brian Parker, McGuire Woods LLP

In addition, James Allen of the Pennsylvania Municipal Retirement System; Paul Halliwell of PERC; staff of the Pennsylvania Department of the Auditor General; and Elliot Dinkin of Cowden Associates, Inc., an actuarial firm, served as resources to the subcommittee. Institute of Politics staff members Marie Hamblett, Moe Coleman, and Bruce Barron supported the subcommittee's work.

The subcommittee completed a draft report in September 2008. During fall 2008, the Institute of Politics conducted additional outreach to stakeholders, discussing the report's five recommendations and their viability with municipal organizations, business representatives, executive branch staff, and others. The subcommittee recognizes that any legislation based on the recommendations in this report will undergo considerable debate and may require further amendment before it can achieve passage. The subcommittee also recognizes that, because of the current economic downturn, increased revenue from taxes on out-of-state companies' insurance policies (required to fund the redistribution of state pension aid envisioned in recommendation three) may not materialize for some time. Nevertheless, after reviewing the feedback received, the subcommittee still considers its five recommendations to be sound.

This report summarizes the subcommittee's activity and recommendations.

Executive Summary

Background on the subcommittee

- Formed by the Fiscal Policy and Governance Committee of the University of Pittsburgh Institute of Politics to examine policy issues related to significant underfunding of municipal pensions in Pennsylvania
- Cochaired by State Representative Dan Frankel and State Senator Jane Orie, with membership from business, labor, government, academia, and philanthropy
- Met 10 times from April 2007 through August 2008

Current status of municipal pension plans: Key issues

- Enormous number of separate local government pension plans—more than 3,000, including more than 2,500 municipal plans
- Inefficiency and high administrative costs, especially in smaller plans
- Significant underfunding, most notably in, but by no means limited to, large cities
- Underfunding as a long-term risk to municipalities' ability to carry out necessary operations
- All but one State Senate district having at least one underfunded plan
- Portability problem
- Wide variance in management: 800 plans managed by the Pennsylvania Municipal Retirement System; many others managed independently
- Substantial state funding (through tax on out-of-state insurance policies sold in Pennsylvania) providing full-cost reimbursement for hundreds of plans

How existing law addresses underfunding

- The Pennsylvania General Assembly became concerned about growing unfunded pension liabilities in the 1970s and 1980s.
- Act 205 of 1984, as amended, requires municipalities to fulfill pension obligations on a 30-year amortization plan (40 years for distressed municipalities).
- Public Employee Retirement Commission reviews plans to verify that municipal contributions comply with funding obligations.
- Pittsburgh and Philadelphia received relief from the General Assembly in 1998, in the form of delayed amortization plan, favorable accounting assumptions, and bonding authority.

Key subcommittee findings

- It is easier to address the asset side of pension funds (i.e., investment management) ~~than the liability side~~ (pension benefits), as promised benefits represent an inviolable commitment to employees.
- Municipalities and state legislators frequently face political pressure to increase benefits. Conversely, it is difficult to pass legislation delaying eligibility for pension benefits, despite increases in life expectancy that lead to higher pension expenditures.
- State pension aid is generous, but any attempt to revise it to assist underfunded plans risks being criticized as a bailout.
- Defined benefit (rather than defined contribution) pension structures are required by state law for many plans and preferred by labor.
- Consolidating plans is difficult because of the various plans and their differing benefit structures; consolidating the administration of plans is more achievable.

Legislative options considered

1. Continuing education for investment officers
2. Consolidation of pension plans (several possible approaches were discussed, including consolidation with the Pennsylvania Municipal Retirement System (PMRS), requiring underfunded and underperforming plans to transfer their assets to state management, or setting a timetable for mandatory consolidation of plans depending on their size)
3. Altering the state pension aid formula
4. Fiduciary responsibility standards
5. Limiting benefit increases by already-underfunded pension plans
6. Relationship between defined-contribution and defined-benefit structures
7. Application of overtime pay to final salary for pension benefit purposes
8. Adjusting formulas for calculating final salary
9. Changing rules governing retirement age
10. Enforcing full funding of plan obligations more strictly

Legislative recommendations

1. Continue education for investment officers
2. Consolidate pension plan administration within PMRS
3. Revise the state aid formula to freeze the unit cost reimbursement at its current rate, require all plans to pay a portion of pension costs, and place leftover revenues in a pool for merit-based distribution to distressed municipal plans
4. Pass fiduciary responsibility legislation to hold professional advisors to a higher fiduciary standard, require that fiduciaries be bonded, impose greater consistency with regard to the assumptions made in actuarial reports, require more detailed reporting from plans that are less than 75 percent funded, and require municipalities to make quarterly contributions to their plans rather than end-of-year contributions
5. Prohibit underfunded pension plans from increasing benefits

The Current Status of Municipal Pensions in Pennsylvania

Lots of plans. As of 2007, Pennsylvania had 3,160 separate pension plans, most of them very small (67 percent of them had 10 or fewer members). This number represents more than one-fourth of the nation's public employee plans. Half of these plans were created after 1974. Of the 3,160 plans, 2,536 are operated by municipalities, 491 by authorities, 72 by counties, and 61 by councils of governments. Overall, Pennsylvania local government pension plans represented 135,000 members and owned more than $18 billion in assets as of the publication of PERC's 2007 Status Report.

Underfunding. There are perhaps 200 underfunded pension plans in Pennsylvania, depending on the criteria used. The Pennsylvania Economy League has prepared maps (see Appendix, Figure 1) identifying the plans that meet one of two criteria for severe underfunding: (1) the ratio of assets to liabilities is less than 70 percent or (2) unfunded liabilities exceed annual payroll. Using these criteria, all but one of Pennsylvania's 50 State Senate districts contained at least one underfunded pension plan.

Lack of efficiency and portability. The enormous number of separate pension plans creates costly inefficiencies. The smallest independently managed plans have significantly higher administrative costs per member (see Appendix, Figure 2). Moreover, police organizations have long complained that the lack of a unified system prevents officers from taking their accumulated pension with them to a new job. Nevertheless, efforts to combine municipal pension plans have been largely unsuccessful.

Management. The experience and abilities of fund administrators vary widely. So do investment policies, as some plans pursue more risky investments in search of higher returns while others are conservative. More than 800 plans have chosen to invest their funds through the Pennsylvania Municipal Retirement System, but hundreds of others continue to manage their own portfolios.

Significant state funding. Since the passage of Act 205 in 1984, municipal pension funds have received state aid financed by a tax on insurance policies sold in Pennsylvania by out-of-state companies. The total amount of state aid coming from this funding stream exceeds $200 million per year. Nearly half of the plans eligible for state aid receive full reimbursement of their pension costs, thereby removing municipalities' motivation to control costs.

The Underfunding Problem and the General Assembly's Response

Although irresponsible management certainly has contributed to some of the municipal pension problems, demographic shifts also have played a role in the largest funding gaps. Whereas newly developed, growing suburbs have few retired workers to support, large cities with declining populations may have as many retirees as current employees (see Appendix, Figure 3). Their pension plans are paying out more money than they receive in current employee contributions, and their tax base is shrinking.

Many municipalities' plans have become seriously underfunded and have fallen into the undesirable practice of relying on current plan contributions to cover obligations to employees who have already retired, rather than fully funding employees' actuarially anticipated benefits during the period of their active employment. Other causes of underfunding have included retroactive benefit increases, failure to comprehend the actual cost of benefit improvements, and too-hopeful investment performance assumptions.

During the 1970s, serious concerns arose regarding the extent to which municipal pension plans in Pennsylvania were becoming underfunded. By 1984, this underfunding had reached an estimated statewide total of $2.9 billion. When the General Assembly created the Public Employee Retirement Study Commission in 1981, it asked the commission to propose legislation that would address these funding deficiencies. In January 1983, the Commission responded with a report recommending the enactment of required actuarial funding standards to be applied to all plans.

In November 1984, the General Assembly enacted such standards as part of Act 205, requiring municipalities to make payments on a schedule that would address any underfunding within 30 years. It also created a state aid system that distributes available funds to municipalities based on their number of full-time employees, with each police officer or firefighter counting as two units and each nonuniformed employee as one unit. Act 205 offered some remedies to distressed municipalities, including a supplemental funding program (which expired in 2003) and the right to set up a 40-year rather than a 30-year funding schedule.

Under Act 205, the Department of the Auditor General is responsible for certifying accuracy of employee unit counts and for calculating disbursement of state aid. Each municipality is responsible for calculating, with the assistance of an actuary, the minimum municipal obligation (MMO) that must be budgeted each year to fulfill the fund's amortization schedule. The Public Employee Retirement Commission (PERC) is responsible for verifying that municipalities are making the appropriate contribution. PERC analyzes the data submitted by municipal pension plans every two years, advises municipalities and the auditor general's office of funding deficiencies, and publishes these deficiencies in its biennial Status Reports. According to PERC's 2007 Status Report, the prevalence of funding deficiencies has declined substantially since the enactment of Act 205; this report found noncompliance with the actuarial funding standard in 74 municipal plans, or less than 4 percent of the 2,228 defined benefit municipal plans in existence at that time.

In 1998, the General Assembly granted additional flexibility to both Pittsburgh and Philadelphia by way of amendments to Act 205. Pittsburgh was permitted to restart its amortization as of 1998, on a new 40-year timetable and with the assumption of a 10 percent interest rate. Philadelphia received a new 30-year amortization timetable and bonding authority.

As of the publication of PERC's 2007 Status Report, the unfunded liabilities of Pennsylvania's municipal pension plans totaled approximately $6.8 billion.

Purpose and Mission of the Subcommittee

At its outset, the Subcommittee recognized that reforming municipal pensions could be an important means of promoting government efficiency. The Subcommittee identified several prominent problems with the present system:

- Rising pension costs, making it increasingly difficult for many municipalities with unfunded pension systems to continue completing the other functions of government
- Lack of pension portability
- Administrative inefficiencies and disparities
- Deficiencies in the statutory framework governing pensions

The subcommittee established two goals: (1) to develop a series of pragmatic policy recommendations to address these problems and (2) to propose ways to educate Pennsylvanians about the problem.

Limitations on the Subcommittee's Scope of Work

The subcommittee's focus on finding pragmatic solutions to municipal pension problems meant that it did not focus on several other areas:

- The subcommittee examined only municipal pensions, not county, state, or public school employee pensions.
- The subcommittee did not deal with retiree health care costs, which ultimately could pose an even more serious fiscal problem at the municipal level than pensions.
- The subcommittee looked for policy solutions that could achieve support from a broad consensus of stakeholders and that thereby have a reasonable chance of passage. Thus, for example, the subcommittee did not review the provisions in Act 111 of 1968 that govern binding arbitration for municipal employees. Some organizations have expressed dissatisfaction with these provisions, but altering them would be difficult except in special cases such as when a municipality is distressed (as already provided under Act 47 of 1987, as amended) or when a pension plan is seriously underfunded (as envisioned in recommendation five of this report).

Subcommittee Activities

The subcommittee received various presentations on issues related to municipal pension policy and directed Institute of Politics staff members to research policy options implemented across the country. From this research, the subcommittee generated a set of 10 possible policy options; obtained input on these policy options from various stakeholder groups, including municipal organizations and labor unions; and drew on this input in developing a list of policy recommendations.

Key Facts

The subcommittee engaged in lengthy and extensive policy discussions. (Meeting summaries and policy analyses prepared for the subcommittee are available on request.) Along the way, important considerations guiding the subcommittee to its policy recommendations included the following:

- Ways to address underfunding problems fall into two basic categories: increasing assets and decreasing liabilities.
- Of these two, the liability side is the much harder one to address, as pension benefits promised to all current employees are inviolable. Benefit changes can be applied only to employees hired after the changes take place.
- Municipal and state officials generally face greater political pressure to increase employee benefits than to constrain them.

- The state pension aid formula is very generous, providing full cost reimbursement to hundreds of plans, including many in newer, financially healthy suburbs with modest legacy costs. However, any attempt to redistribute state funds will face strong opposition, particularly to the extent that it is seen as a bailout of municipalities that failed to fund their pension plans responsibly.
- Municipal pension structures take into consideration that many municipal employees have physically demanding and (for police and firefighters) hazardous jobs. In addition, some municipal employees do not participate in Social Security.
- Act 205 already contains suitable provisions to require municipalities to eliminate unfunded liabilities, although the General Assembly has granted significant exceptions to Pittsburgh and Philadelphia.
- Defined-contribution plans (under which the employer places a certain amount of money each month in active employees' pension accounts) have more predictable fiscal obligations than defined-benefit plans (under which retirees are guaranteed a certain monthly payment, based on salary level and longevity of employment, from retirement until death). However, defined-benefit plans better fulfill the original purpose of pension plans (to provide retirement security) and are preferred by labor.
- Despite increasing life expectancies, it is difficult to enact legislation that would raise the retirement age or tighten eligibility requirements for retirement.
- Consolidating existing pension plans is onerous because the plans contain different benefit structures that cannot be altered for present employees. However, it is possible to consolidate administration of pension plans without consolidating benefit structures.

Options Reviewed

The subcommittee considered the following policy areas in its review:

1. Continuing education for investment officers
2. Consolidation of pension plans (several possible approaches were discussed, including consolidation with the Pennsylvania Municipal Retirement System, requiring underfunded and underperforming plans to transfer their assets to state management, or setting a timetable for mandatory consolidation of plans depending on their size)
3. The state pension aid formula
4. Fiduciary responsibility standards
5. Limiting benefit increases by already-underfunded pension plans
6. Relationship between defined-contribution and defined-benefit structures
7. Application of overtime pay to final salary for pension benefit purposes
8. Formula for calculating final salary
9. Rules governing retirement age
10. Enforcing full funding of plan obligations more strictly

The subcommittee determined that it could not make viable recommendations for policy change in areas 6 through 9. With regard to defined-contribution vs. defined-benefit plans (area 6), subcommittee members did not reach consensus but recognized the need to balance labor's concerns for pension security with municipalities' concerns for controlling costs. Several members of the subcommittee intend to continue pursuing policy options in this area.

The subcommittee further determined that existing legislation is sufficient to result in full funding of plan obligations (policy area 10), provided that state agencies continue to enforce adherence to MMOs and that the General Assembly does not continue to grant generous loopholes such as the relief given to Pittsburgh and Philadelphia in 1998. Accordingly, the subcommittee's recommendations focus on the first five of the policy areas listed. (These recommendations are presented in the order in which the subcommittee reviewed them, not in order of priority.)

Recommendations

1. Continuing education for investment officers. The subcommittee believes it is reasonable to expect that those responsible for managing local governments' investment decisions be properly trained. Therefore, it proposes requiring each local government to designate an "investment officer" and requiring municipal treasurers and investment officers to receive at least six hours a year of continuing education on investment responsibilities. This training also should cover GASB 43 and 45, the accounting standards adopted in 2004 that cover accounting and financial reporting of other post-employment benefits (OPEB) offered by government employers and their benefit plans.

2. Consolidation of local government pension plans within the Pennsylvania Municipal Retirement System (PMRS). Most of the arguments for consolidation of local government plans are actually calls ~~for administrative~~ consolidation, not necessarily for standardization of benefits. Accordingly, the desired policy goals, such as portability and administrative efficiency, could be achieved by consolidating asset administration (but not benefit structures) through the transition of all plans to PMRS management. PMRS already administers hundreds of plans with different benefit structures and, should the state mandate consolidation, would be the logical vehicle to manage the plans.

The subcommittee believes that such a consolidation could proceed more smoothly if implemented incrementally—e.g., incorporating all plans with fewer than 10 employees over the first three years, then plans of 10–20 employees, and completing the consolidation over a 12-year period.

Currently, a municipality wishing to place its plan under PMRS management must receive approval from 75 percent of its employees, so a mandatory statewide consolidation within PMRS would require a change of this policy.

PMRS currently awards member plans a regular interest rate of 6 percent each year, plus an excess interest dividend in years when investment performance provides a sufficient surplus. In years where PMRS awards excess interest dividends, it may be desirable to enact a requirement that municipalities with seriously underfunded pension plans must use the dividend to reduce unfunded liability, not to provide additional benefits to plan members, until the pension plan attains a minimum funding ratio of at least 80 percent (see recommendation five below) and is on a clear path to reaching a 100 percent funded ratio.

Some municipalities with fully funded, effectively managed plans may object to consolidation. The subcommittee believes an opt-out provision for plans that are fully funded and that have achieved long-term returns comparable to those of PMRS would certainly be appropriate.

3. State aid formula revision. The subcommittee recommends the following changes to the provisions governing state aid to municipal pensions:

- Require all local governments to pay a portion of their pension plan costs.
- Freeze the unit cost reimbursement at the current amount, which was $3,186 in 2008.

In the event that insurance revenue drops, the unit cost reimbursement should be recalculated and set at a new, lower amount. However, it should not be increased for a defined period of five or 10 years.

The extra funds generated by holding the unit cost reimbursement rate steady as insurance revenue increases could be placed in a pool for distribution to distressed municipalities. Reimbursement could be based on a formula that accounts for factors such as local financial participation, investment performance, or responsible management practices.

Municipalities that have substantial obligations to retired workers but whose reimbursement amount is dropping due to cuts in the current workforce could be considered for supplemental assistance.

4. Fiduciary responsibility legislation. The subcommittee recommends that the General Assembly consider enacting several measures that would enhance the level of fiduciary responsibility required of pension plans and their managers. Such measures include:

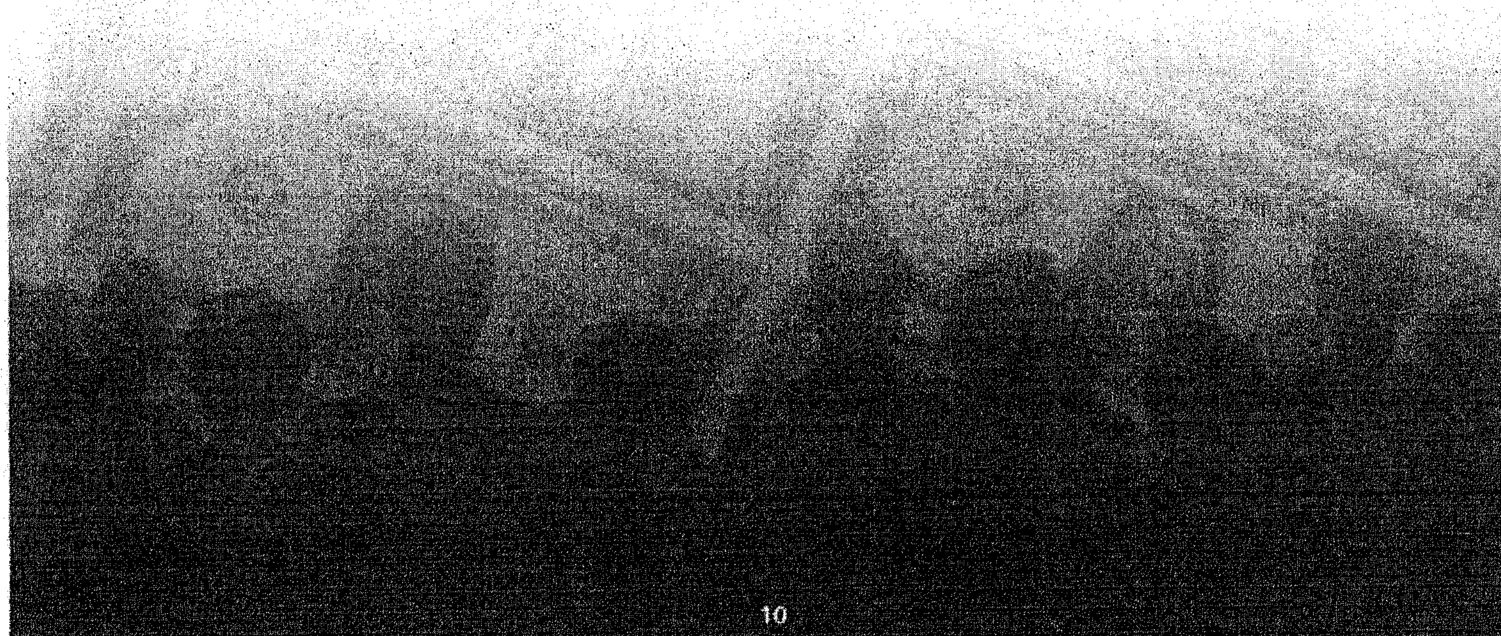
- Holding professional advisors of municipal pension plans to a higher fiduciary standard;
- Requiring that pension plan fiduciaries be bonded;
- Imposing greater consistency upon the assumptions made in actuarial valuation reports, so as to permit more uniform identification of pension plans' funding ratios or the impact of proposed benefit increases;
- Requiring plans that are less than 75 percent funded to report in greater detail on their obligations to retirees;
- Requiring municipal contributions to pension plans on a quarterly rather than an end-of-year basis.

5. Prohibit underfunded plans from increasing benefits. The subcommittee recommends that Pennsylvania follow Missouri's example by enacting legislation that prohibits municipalities from authorizing pension benefit increases unless their pension plan would be at least 80 percent funded after taking the increased liability into account. Such a provision would prevent municipalities still catching up on prior underfunding of plans from approving further benefits that they could not easily afford.

Educating the Public on Pension Needs

It is difficult to engage the general public in discussions of municipal pensions. Beyond the pension beneficiaries themselves, municipal governments, labor organizations, public agencies (such as the Pennsylvania Municipal Retirement System, Public Employees Retirement Commission, and state employee retirement systems), and professional actuaries are the only direct stakeholders; others are concerned only to the extent that public pension costs may affect their taxes or seriously impair government operations.

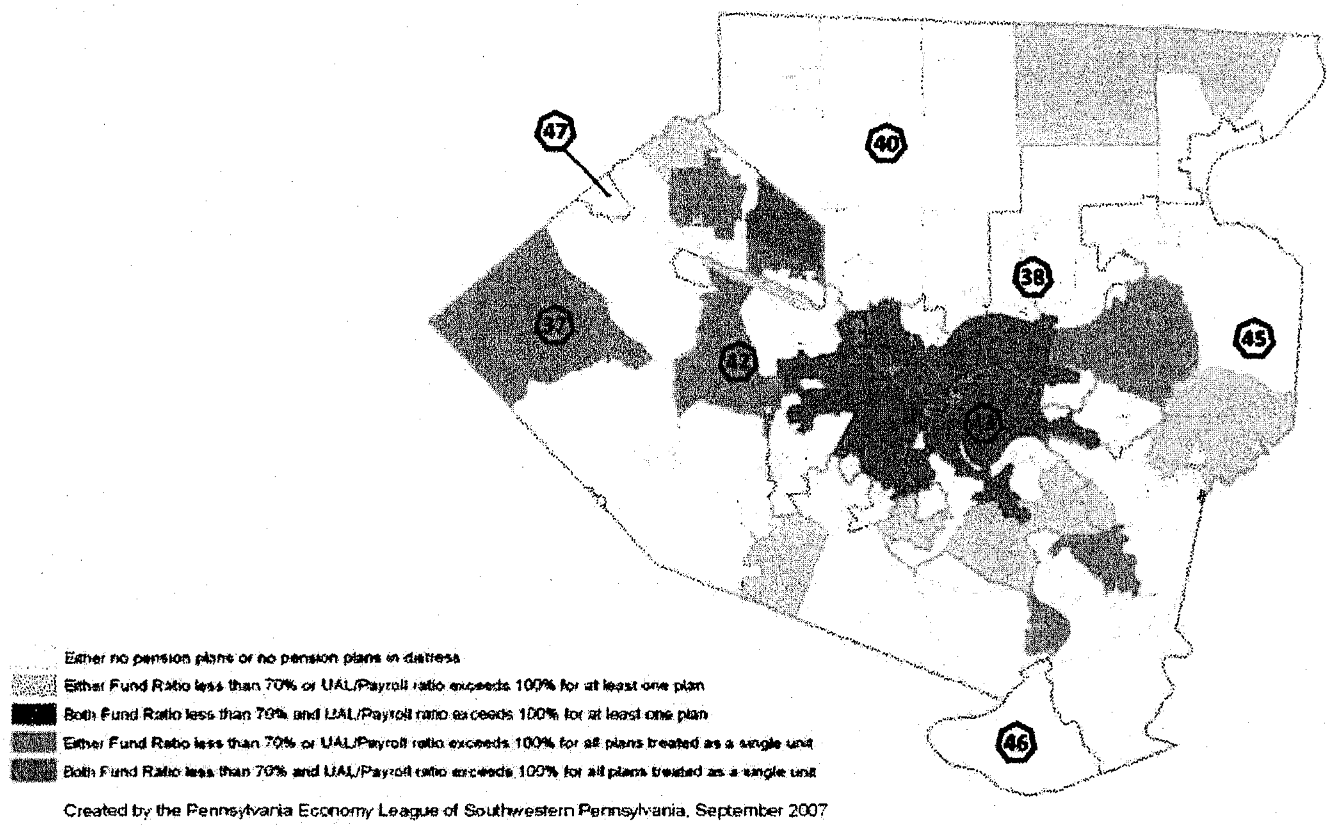
The subcommittee encourages ongoing public outreach (using this report and perhaps other communication tools) to build support for policy actions that would make Pennsylvania's municipal pension system more sustainable.



Appendices

Figure 1: Pennsylvania Economy League pension distress maps
NOTE: Figures 1a–1d show the location of underfunded pension plans by Pennsylvania State Senate and State House districts as of 2007. The lists of legislators have been updated to reflect the 2008 election.
Figure 2: Per Member Administrative Cost for Selected Municipal Pension Plans Based on Pension Plan Size
Figure 3: Ratio of Active Members to Beneficiaries

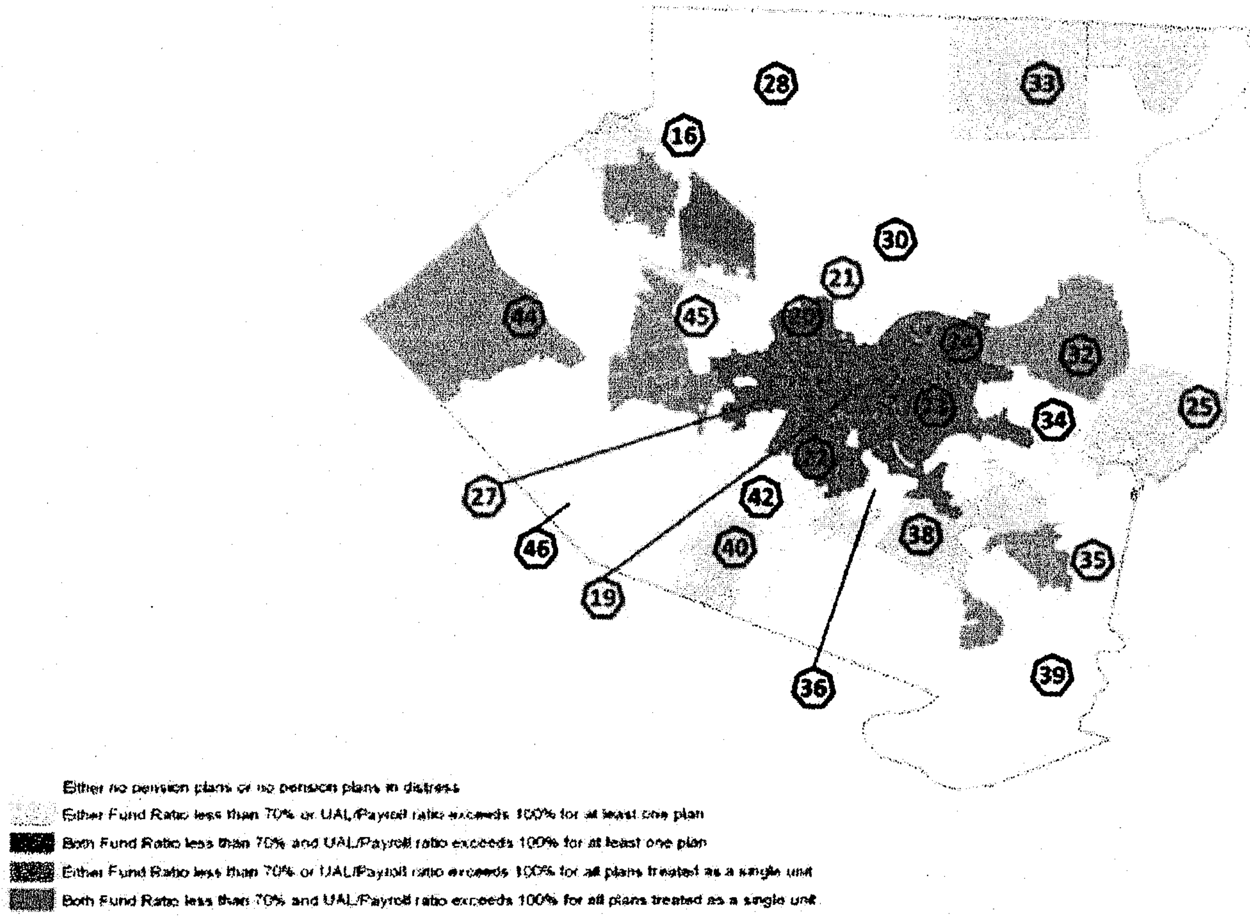
Figure 1a: Allegheny County State Senate Districts



Allegheny County State Senate Districts:

37 Pippy, John (R)
38 Ferlo, Jim (D)
40 Orie, Jane Clare (R)
42 Fontana, Wayne D. (D)
43 Costa, Jay (D)
45 Logan, Sean (D)
46 Stout, J. Barry (D)
47 Vogel, Elder A., Jr. (R)

Figure 1b: Allegheny County State House Districts

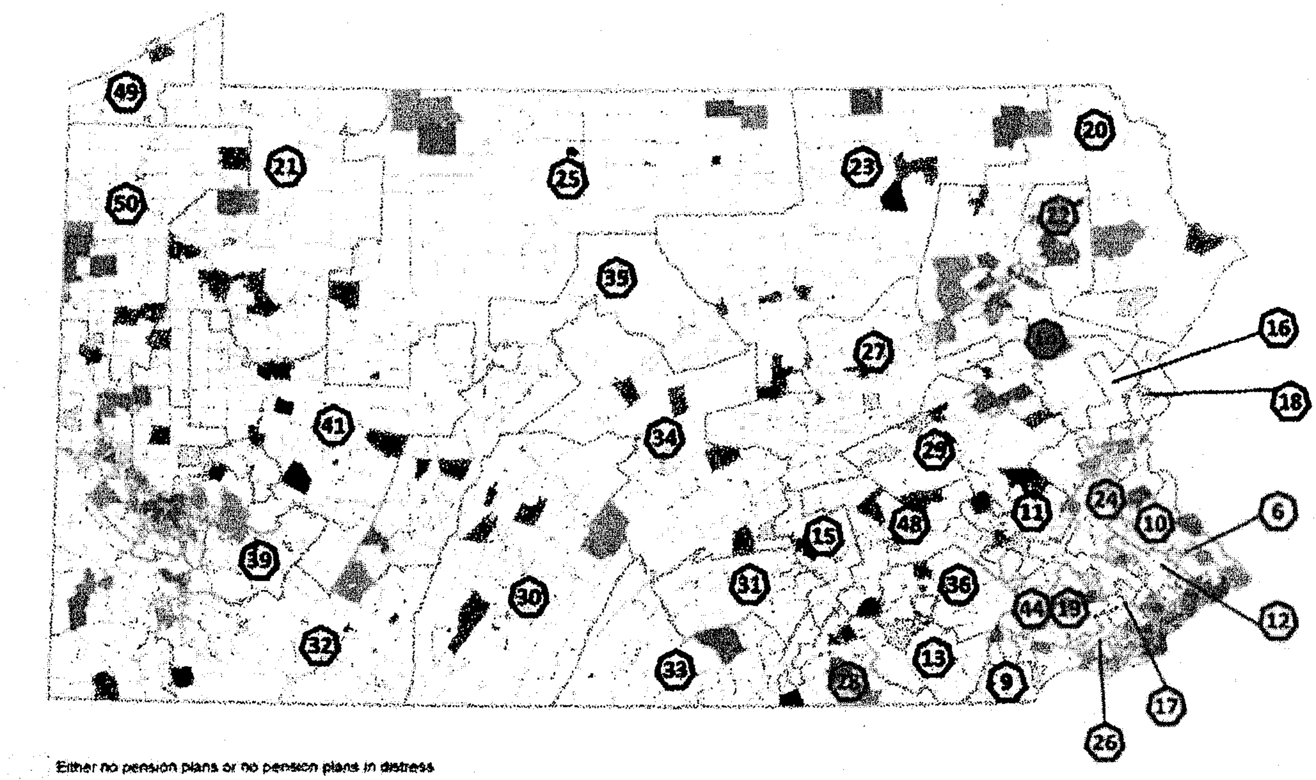


Created by the Pennsylvania Economy League of Southwestern Pennsylvania. September 2007

Allegheny County State House Districts

16 Matzie, Robert F. (D)
19 Wheatley, Jake (D)
20 Walko, Don (D)
21 Costa, Dom (D)
22 Wagner, Chelsa (D)
23 Frankel, Dan (D)
24 Preston, Joseph, Jr. (D)
25 Markosek, Joseph F. (D)
27 Deasy, Daniel J. (D)
28 Turzai, Mike (R)
30 Vulakovich, Randy (R)
32 DeLuca, Anthony M. (D)
33 Dermody, Frank (D)
34 Costa, Paul (D)
35 Gergely, Marc J. (D)
36 Readshaw, Harry (D)
38 Kortz, II, William C. (D)
39 Levdansky, David K. (D)
40 Maher, John (R)
42 Smith, Matthew (D)
44 Mustio, T. Mark (R)
45 Kotik, Nick (D)
46 White, Jesse (D)

Figure 1c: Pennsylvania State Senate Districts



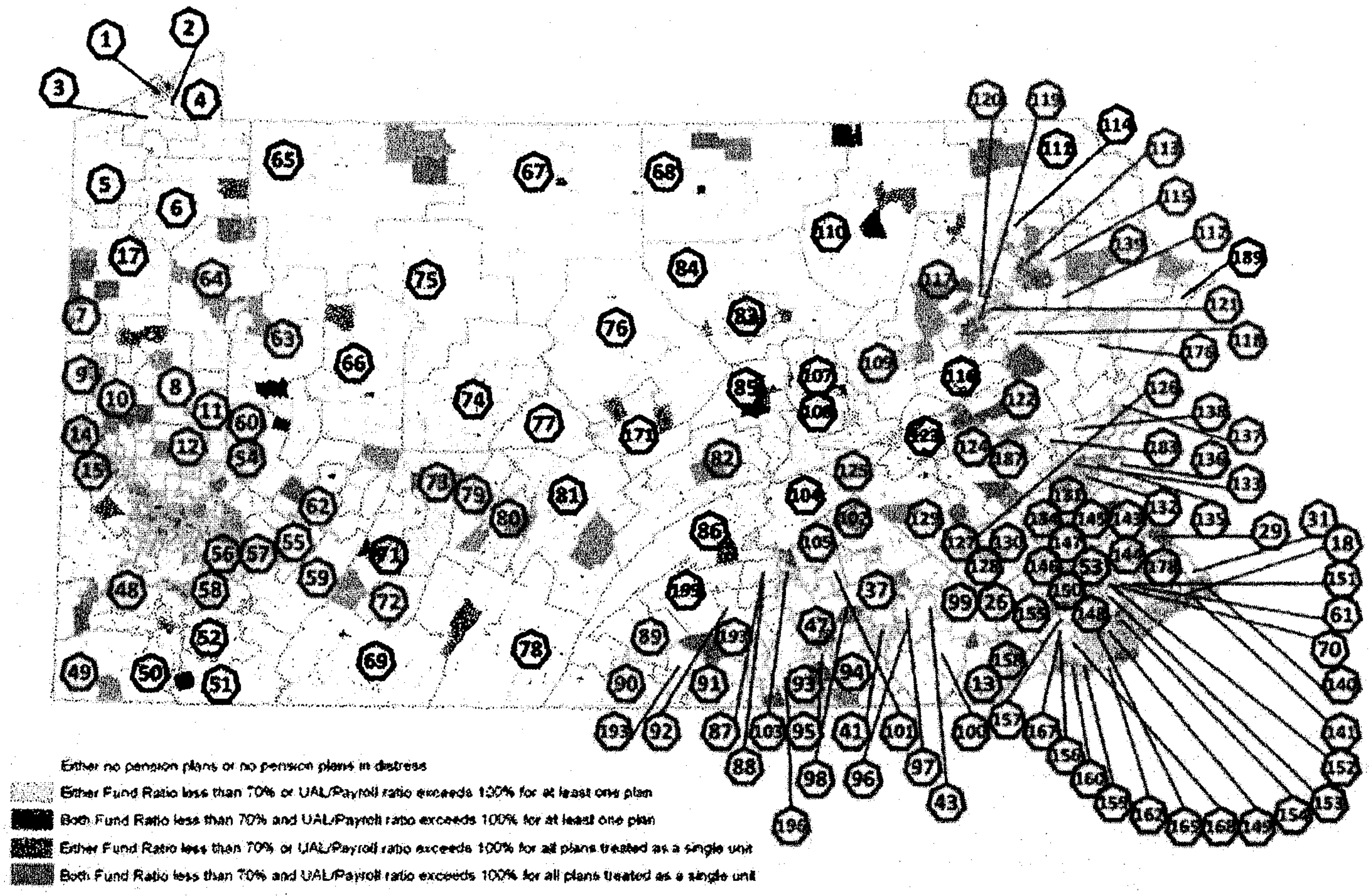
Either no pension plans or no pension plans in distress
Either Fund Ratio less than 70% or UAL/Payroll ratio exceeds 100% for at least one plan
Both Fund Ratio less than 70% and UAL/Payroll ratio exceeds 100% for at least one plan
Either Fund Ratio less than 70% or UAL/Payroll ratio exceeds 100% for all plans treated as a single unit
Both Fund Ratio less than 70% and UAL/Payroll ratio exceeds 100% for all plans treated as a single unit

Created by the Pennsylvania Economy League of Southwestern Pennsylvania, September 2007

Pennsylvania State Senate Districts

1 Farnese, Lawrence M., Jr. (D)
2 Tartaglione, Christine M. (D)
3 Kitchen, Shirley M. (D)
4 Washington, Leanna M. (D)
5 Stack, Michael J. (D)
6 Tomlinson, Robert M. (R)
7 Hughes, Vincent J. (D)
8 Williams, Anthony H. (D)
9 Pileggi, Dominic (R)
10 McIlhinney, Charles T., Jr. (R)
11 O'Pake, Michael A. (D)
12 Greenleaf, Stewart J. (R)
13 Smucker, Lloyd K. (R)
14 Musto, Raphael J. (D)
15 Piccola, Jeffrey E. (R)
16 Browne, Patrick M. (R)
17 Leach, Daylin (D)
18 Boscola, Lisa M. (D)
19 Dinniman, Andrew E. (D)
20 Baker, Lisa (R)
21 White, Mary Jo (R)
22 Mellow, Robert J. (D)
23 Yaw, Gene (R)
24 Wonderling, Robert C. (R)
25 Scarnati, Joseph B., III (R)
26 Erickson, Edwin B. (R)
27 Gordner, John R. (R)
28 Waugh, Michael L. (R)
29 Argall, David G. (R)
30 Eichelberger, John H. (R)
31 Vance, Patricia H. (R)
32 Kasunic, Richard A (D)
33 Alloway, Richard L., II (R)
34 Corman, Jake (R)
35 Wozniak, John N. (D)
36 Brubaker, Michael W. (R)
37 Pippy, John (R)
38 Ferlo, Jim (D)
39 Ward, Kim L. (R)
40 Orie, Jane Clare (R)
41 White, Donald C. (R)
42 Fontana, Wayne D. (D)
43 Costa, Jay (D)
44 Rafferty, John C., Jr. (R)
45 Logan, Sean (D)
46 Stout, J. Barry (D)
47 Vogel, Elder A., Jr. (R)
48 Folmer, Mike (R)
49 Earll, Jane M. (R)
50 Robbins, Robert D. (R)

Figure 1d: Pennsylvania State House Districts



Created by the Pennsylvania Economy League of Southwestern Pennsylvania, September 2007

Pennsylvania State House Districts

1 Harkins, Patrick J. (D)
2 Fabrizio, Florindo J. (D)
3 Hornaman, John (D)
4 Sonney, Curtis G. (R)
5 Evans, John R. (R)
6 Roae, Brad (R)
7 Longietti, Mark (D)
8 Stevenson, Richard R. (R)
9 Sainato, Chris (D)
10 Gibbons, Jaret (D)
11 Ellis, Brian L. (R)
12 Metcalfe, Daryl D. (R)
13 Houghton, Tom (D)
14 Marshall, Jim (R)
15 Christiana, Jim (R)
16 Matzie, Robert F. (D)
17 Brooks, Michele (R)
18 DiGirolamo, Gene (R)
19 Wheatley, Jake (D)
20 Walko, Don (D)
21 Costa, Dom (D)
22 Wagner, Chelsa (D)
23 Frankel, Dan (D)
24 Preston, Joseph, Jr. (D)
25 Markosek, Joseph F. (D)
26 Hennessey, Tim (R)
27 Deasy, Daniel J. (D)
28 Turzai, Mike (R)
29 O'Neill, Bernie (R)
30 Vulakovich, Randy (R)
31 Santarsiero, Steven J. (D)
32 DeLuca, Anthony M. (D)
33 Dermody, Frank (D)
34 Costa, Paul (D)
35 Gergely, Marc J. (D)
36 Readshaw, Harry (D)
37 Creighton, Tom C. (R)
38 Kortz, William C., II (D)
39 Levdansky, David K. (D)
40 Maher, John (R)
41 True, Katie (R)
42 Smith, Matthew (D)
43 Boyd, Scott W. (R)
44 Mustio, T. Mark (R)
45 Kotik, Nick (D)
46 White, Jesse (D)
47 Gillespie, Keith (R)
48 Solobay, Timothy J. (D)
49 Daley, Peter J. (D)
50 DeWeese, H. William (D)
51 Mahoney, Tim (D)
52 Kula, Deberah (D)
53 Godshall, Robert W. (R)
54 Pallone, John E. (D)

55 Petrarca, Joseph A. (D)
56 Casorio, James E. (D)
57 Krieger, Tim (R)
58 Harhai, R. Ted (D)
59 Reese, Mike (R)
60 Pyle, Jeffrey P. (R)
61 Harper, Kate (R)
62 Reed, Dave (R)
63 Oberlander, Donna (R)
64 Hutchinson, Scott E. (R)
65 Rapp, Kathy L. (R)
66 Smith, Samuel H. (R)
67 Causer, Martin T. (R)
68 Baker, Matthew E. (R)
69 Metzgar, Carl Walker (R)
70 Bradford, Matthew D. (D)
71 Barbin, Bryan (D)
72 Burns, Frank (D)
73 Haluska, Gary (D)
74 George, Camille Bud (D)
75 Gabler, Matt (R)
76 Hanna, Michael K. (D)
77 Conklin, H. Scott (D)
78 Hess, Dick L. (R)
79 Geist, Richard A. (R)
80 Stern, Jerry (R)
81 Fleck, Mike (R)
82 Harris, C. Adam (R)
83 Mirabito, Rick (D)
84 Everett, Garth D. (R)
85 Fairchild, Russell H. (R)
86 Keller, Mark K. (R)
87 Grell, Glen R. (R)
88 DeLozier, Sheryl M. (R)
89 Kauffman, Rob W. (R)
90 Rock, Todd (R)
91 Moul, Dan (R)
92 Perry, Scott (R)
93 Miller, Ron (R)
94 Saylor, Stan (R)
95 DePasquale, Eugene (D)
96 Sturla, P. Michael (D)
97 Bear, John C. (R)
98 Hickernell, David S. (R)
99 Denlinger, Gordon (R)
100 Cutler, Bryan (R)
101 Gingrich, Mauree (R)
102 Swanger, RoseMarie (R)
103 Buxton, Ron (D)
104 Helm, Susan C. (R)
105 Marsico, Ron (R)
106 Payne, John D. (R)
107 Belfanti, Robert E., Jr. (D)
108 Phillips, Merle H. (R)
109 Millard, David R. (R)
110 Pickett, Tina (R)
111 Major, Sandra (R)
112 Smith, Ken (D)
113 Murphy, Kevin P. (D)
114 Wansacz, James (D)
115 Staback, Edward G. (D)
116 Eachus, Todd A. (D)
117 Boback, Karen (R)
118 Carroll , Mike (D)
119 Yudichak, John T. (D)
120 Mundy, Phyllis (D)
121 Pashinski, Eddie Day (D)
122 McCall, Keith R. (D)
123 Goodman, Neal (D)
124 Knowles, Jerry (R)
125 Seip, Tim (D)
126 Santoni, Dante, Jr. (D)
127 Caltagirone, Thomas R. (D)
128 Rohrer, Sam (R)
129 Cox, Jim (R)
130 Kessler, David R. (D)
131 Beyer, Karen D. (R)
132 Mann, Jennifer (D)
133 Brennan, Joseph F. (D)
134 Reichley, Douglas G. (R)
135 Samuelson, Steve (D)
136 Freeman, Robert (D)
137 Grucela, Richard T. (D)
138 Dally, Craig A. (R)
139 Peifer, Michael (R)
140 Galloway, John T. (D)
141 Melio, Anthony J. (D)
142 Farry, Frank A. (R)
143 Quinn, Marguerite (R)
144 Watson, Katharine M. (R)
145 Clymer, Paul I. (R)
146 Quigley, Thomas J. (R)
147 Mensch, Bob (R)
148 Gerber, Michael (D)
149 Briggs, Tim (D)
150 Vereb, Mike (R)
151 Taylor, Rick (D)
152 Murt, Thomas P. (R)
153 Shapiro, Josh (D)
154 Curry, Lawrence H. (D)
155 Schroder, Curt (R)
156 McIlvaine Smith, Barbara (D)
157 Drucker, Paul J. (D)
158 Ross, Chris (R)
159 Kirkland, Thaddeus (D)
160 Barrar, Stephen (R)
161 Lentz, Bryan R. (D)
162 Miccarelli, Nick (R)
163 Micozzie, Nicholas A. (R)
164 Civera, Jr., Mario J. (R)
165 Adolph, William F., Jr. (R)
166 Vitali, Greg (D)
167 Milne, Duane (R)
168 Killion, Thomas H. (R)
169 O'Brien, Dennis M. (R)
170 Boyle, Brendan F. (D)
171 Benninghoff, Kerry A. (R)
172 Perzel, John M. (R)
173 McGeehan, Michael P. (D)
174 Sabatina, John P., Jr. (D)
175 O'Brien, Michael H. (D)
176 Scavello, Mario M. (R)
177 Taylor, John (R)
178 Petri, Scott A. (R)
179 Payton, Tony J., Jr. (D)
180 Cruz, Angel (D)
181 Thomas, W. Curtis (D)
182 Josephs, Babette (D)
183 Harhart, Julie (R)
184 Keller, William F. (D)
185 Donatucci, Robert C. (D)
186 Johnson, Kenyatta J. (D)
187 Day, Gary (R)
188 Roebuck, James R., Jr. (D)
189 Siptroth, John J. (D)
190 Brown, Vanessa Lowery (D)
191 Waters, Ronald G. (D)
192 Bishop, Louise Williams (D)
193 Tallman, Will (R)
194 Manderino, Kathy (D)
195 Oliver, Frank Louis (D)
196 Grore, Seth M. (R)
197 Williams, Jewell (D)
198 Youngblood, Rosita C. (D)
199 Gabig, Will (R)
200 Parker, Cherelle L. (D)
201 Myers, John (D)
202 Cohen, Mark B. (D)
203 Evans, Dwight (D)

Figure 2: Per Member Administrative Cost for Selected Municipal Pension Plans Based on Pension Plan Size

Pension Plan Size	Per Member Administrative Cost
10 or Fewer Active Members	$1,519.86
11 to 100 Active Members	$1,002.99
More Than 100 Active Members	$362.76
More Than 500 Active Members	$302.74

Source: *PERC Status Report on Local Government Pension Plans*, December 2008, page 6

Figure 3: Ratio of Active Members to Beneficiaries

	Ratio
Cities	1:1.2
Boroughs	1:0.5
First Class Townships	1:0.5
Second Class Townships	1:0.3

Source: Presentation to Institute of Politics Pensions Subcommittee by Allegheny Conference on Community Development, April 2007

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