Pension Relief Bill Signed by Governor – Act 44 of 2009

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House Bill 1828 (PN 2638) or Act 44 of 2009, offers relief and restructuring of pension payments for all municipalities. The legislation amends Act 205 of 1984 – The Municipal Pension Funding Standard and Recovery Act.

For background purposes, House Bill 1828 passed the House in August as a bill authorizing Philadelphia to increase its sales tax by 1% to pay for pension obligations. In the Senate, however, the bill was amended significantly. Language from House Bills 1874 and 1884 was added. These bills housed a municipal pension recovery plan that provided both optional and mandatory tools to assist municipalities in meeting their annual pension obligations and getting plans back up to adequate funding levels. The Senate also added some stronger pension reform language that would have curbed collective bargaining, and allowed for defined contribution plans in instances of severe distress. Finally, the Senate liberalized benefits by authorizing Deferred Retirement Option Plans, or DROPs, as a legal benefit for all municipalities to offer.

When the bill came back to the House for its concurrence on the Senate's amendments, the House was lobbied very hard by the FOP and firefighters unions to remove any limits on collective bargaining. Additionally, the City of Pittsburgh did not want to be brought under the mandatory provisions for severely distressed plans and lobbied for an exemption.

The House stripped out most of the reform measures the Senate adopted. It removed provisions that mandated PMRS takeover of severely distressed plans. The House also gave Pittsburgh authorization to increase its parking tax and a two year exemption from the take-over provisions regarding distressed pension plans.

The Senate agreed with the House amendments on September 17, one day before Philadelphia was slated to send out lay-off notices to thousands of employees, including police and fire personnel. And the Governor signed the bill on the evening of September 18.

Following is a summary of the legislation:

Act 44 provides new amortization schedules and smoothing techniques that are optional and may be used with the 2009 actuarial valuation reports. The law also provides new remedies for municipalities whose aggregated plans fall into specific categories of distress. Most of the remedies are voluntary, but some are mandatory at the moderate and severely distressed levels.

Amortization:
Amortization periods have been amended to reflect voluntary and involuntary changes to plans, as well as actuarial gains and losses. For plan changes on or after the effective date of the act: amortization of assumption changes has been reduced to 15 years from 20 years; amortization of plan benefit enhancements for active members made at the local level has been reduced to 10 years from 20 years; plan benefit enhancements for retired members made at the local level must be paid in 1 year; and state mandated benefits may now be amortized over 20 years, rather than 10 years.

Effective immediately and for the 2009 actuarial valuation reports, the amortization period for actuarial gains and losses is increased from 15 to 20 years.

Smoothing:
The standard limit of a 20% smoothing corridor above or below market value is increased to 30%. This optional tool is only temporary for the 2009 actuarial valuation reporting period. However, if a municipality falls into one of the distress categories, the ability to use the 30% smoothing tool for additional two-year periods kicks in. In Level 1, the 30% is allowed to be used for an additional two-year period or 4 years in total. Level 2 and Level 3 municipalities may use the technique for two additional two-year periods or 6 years in total.

Levels of Distress:
Chapter 6 of Act 205 regarding distressed plans is amended. Beginning with the 2009 actuarial valuation reports, the Public Employee Retirement Commission will review the reports filed for each municipal pension plan and determine a municipality's eligibility based on the funding ratio of all of its plans combined. The level of distress dictates the remedies available to a municipality.

Level 1:
Municipalities falling into Level 1 will have a funding ratio of 70% to 89%. At Level 1, the remedies are optional and include:

- Aggregation of trust funds pursuant to section 607 (b).
- Establishment of total member contribution pursuant to section 607 (c).
- Deviation from municipal contribution limitations pursuant to section 607 (d).
- Election to pay a reduced MMO for one biennial actuarial valuation period pursuant to section 607 (h.1). The payment shall consist of the normal cost and administrative expenses, plus 75% of the amortization contribution, minus member contributions.
- Election to utilize the 30% smoothing corridor for an additional actuarial valuation reporting period pursuant to section 210 (c).

Level 2:
Municipalities falling into Level 2 will have a funding ratio of 50% to 69%. At Level 2 the remedies are both mandatory and discretionary.
The mandatory remedies are:

- Aggregation of the trust funds pursuant to section 607 (b).
- Submission of a plan for administrative improvement pursuant to section 607 (i).

The discretionary remedies are:

- Establishment of total member contributions pursuant to section 607 (c).
- Deviation from municipal contribution limitations pursuant to section 607 (d).
- Establishment of a revised benefit plan for newly hired municipal employees pursuant to section 607 (e).
- Special taxing authority pursuant to section 607 (f).
- Election to pay a reduced MMO for two biennial actuarial valuation periods pursuant to section 607 (h.1). The payment shall consist of the normal cost and administrative expenses plus 75% of the amortization contribution, minus member contributions.
- Election to utilize the 30% smoothing corridor for two additional actuarial valuation reporting periods pursuant to section 210 (c).

Level 3:
Municipalities falling into Level 3 will have a funding ratio of below 50%. At Level 3 there are both mandatory and discretionary remedies.
The mandatory remedies are:

- Aggregation of the trust funds pursuant to section 607 (b).
- Establishment of a revised benefit plan for new hires pursuant to section 607 (e).
- Preparation, submission and implementation of the pension plan or plans pursuant to section 607 (i).

The discretionary remedies are:

- Establishment of total member contributions pursuant to section 607 (c).
- Deviation from municipal contribution limitations pursuant to section 607 (d).
- Special taxing authority pursuant to section 607 (f).
- Election to pay a reduced MMO for three biennial actuarial valuation periods pursuant to section 607 (h.1). The payment shall consist of the normal cost and administrative expenses plus 75% of the amortization contribution, minus member contributions.
- Election to utilize the 30% smoothing corridor for two additional actuarial valuation reporting periods pursuant to section 210 (c).

Deferred Retirement Option Plans, or DROPs:
Act 44 authorizes local governments to establish DROPs, and establishes uniform rules for DROP plans. Such plans are prohibited from including elected officials. Furthermore, DROPs are excluded from actuarial reporting and funding standards, and participants are not considered active members in terms of unit value. DROPs are to be established by ordinance. For municipalities in PMRS, PMRS will establish a uniform DROP open to any local government in its system.

Active members of a local government retirement system who are eligible for normal retirement benefits are eligible to participate in the DROP. Such members must resign from regular employment and submit an irrevocable written election to participate in the DROP. Additionally, members are required to forgo active membership in the retirement system, any growth in the salary base used to calculate the regular retirement benefit, and any additional benefit accrual for retirement purposes.

While participating in the DROP, all of the retired member's monthly, normal retirement benefit and interest at the assigned rate shall be credited to the DROP participant's subsidiary DROP participant account. On the date of the DROP participant's termination of employment, the retirement system shall calculate and pay over the participant's total accumulated benefits in his or her subsidiary account. If a DROP participant becomes eligible for a disability pension and terminates employment, his or her retirement benefit under the DROP will terminate. DROP participants are eligible for all preretirement benefits for employees otherwise provided by law.

Any local governments that create DROPs must also establish a participant account as an interest bearing ledger account in its pension fund. A separate interest bearing subsidiary DROP account must be established for each participant. While a DROP participant, the member's monthly retirement benefit and interest shall be credited to the account. The interest shall be compounded and credited monthly at the actual rate earned by the participant account, which shall be no less than 1% and no more then 4.5%.

Pittsburgh and Philadelphia:
Act 44 contains new taxing authority for both Pittsburgh and Philadelphia. Pittsburgh is authorized to increase its parking tax. A portion of the revenue must be used to help pay pension obligations. Pittsburgh has two years to get its plans up to 50% funded. If that goal is not reached by September 2011, PMRS will take over and administer Pittsburgh's plans.

Philadelphia was authorized to increase its sales tax by 1% for 5 years. The new revenue must also go directly to pension obligations. The City was also authorized to amortize its entire unfunded liability over 30 years.

Professional Services Contracts for Pension Systems:
Act 44 establishes new requirements for awarding professional service contracts by municipal pension systems and by PMRS.

This legislation, with its many twists and turns, represents a successful lobbying effort for PLCM. At the end of 2008, we were already hearing from members about upcoming pension obligations they would have difficulty meeting. Our initial efforts centered on a basic amortization tool to mitigate investment losses. We supported the recovery plan developed by PERC and worked to get it introduced. We testified at several hearings on pension and fiscal matters and supported the Senate's reform measures. The end result is not pension reform, but tools to effectively address the future payment obligations every municipality will face.

Please see the Summer issue of the ***Municipal Reporter*** *magazine, arriving this month, for a feature article on the most effective implementation of these amortization and smoothing tools.*