COMMONWEALTH OF PENNSYLVANIA
PUBLIC EMPLOYEE RETIREMENT COMMISSION
HARRISBURG
17120

March 8, 1999

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Mr. Virgil F. Puskarich
Executive Director
Local Government Commission
Senate Box 203078
633 Main Capitol Building
Harrisburg, PA 17120-3078

Re: March 25, 1999,
House Resolution 167 Meeting
Task Force Assignment

Dear Mr. Puskarich:

I am enclosing my Task Force assignment on the Statewide Retirement System for Local Government Employees in response to your January 22, 1999, correspondence.

Should you have any questions, please contact me at 783-6100.

Sincerely,

Anthony W. Salomone
Executive Director

Enclosure

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Part I
Statewide Retirement System For Local Government Employees

Arguments in favor of the reform include:

- The Commonwealth uses 2,700 individual administrative units to provide pension benefits to municipal employees. The inefficiency inherent in this decentralized administration needlessly increases the operating costs of local governments by more than $60 million annually. As with other inflated government functions, downsizing the administrative structure used to provide municipal pension benefits is necessary to lower the cost of government and thereby increase the State's ability to compete economically in the next century. By replacing 2,700 administrative units with one administrative unit, the Commonwealth will be administering municipal pension benefits the same way all other states do and experiencing the associated operational efficiencies.

- A statewide retirement system for local government employees would provide a uniform structure of benefits with eight optional membership classifications that accommodate the varying needs of local governments. A uniform structure would:

  1) simplify the operation of the collective bargaining process with regard to municipal pension benefits by providing only standard benefit options and ensuring reliable cost estimates;

  2) eliminate piecemeal "leapfrog" competition between municipal employees for improved pension benefits;

  3) establish a manageable mechanism for the provision of retirement benefits other than pensions such as life insurance;

  4) facilitate access to complete information on benefit provisions by municipal employees and other interested parties through the use of a single statute; and

  5) establish equity in the level of pension benefits provided to municipal employees.

- Making an extended (20-year) transition from 2,700 administrative agencies to one administrative agency would:

  1) minimize the impact on private sector service providers currently engaged by municipal pension plans;

  2) eliminate duplication of administrative functions and reduce the annual administrative costs by more than $8 million;

  3) improve administrative functions by ensuring a consistent level of performance through the use of full-time, professional staff;

4) free-up substantial administrative capacity in local government operations that is now informally used for pension plan administration;

5) permit local governments to monitor and control municipal pension plan assets and cost determinations through a separate Local Government Retirement Board; and

6) allow for statewide portability of retirement benefits among all public sector employers including state government, local governments and school districts.

<u>Arguments in opposition to the reform include:</u>

- Municipalities will lose control of their employee retirement plans. Implementation of a statewide retirement system would:

  1) reduce flexibility in the retirement benefits provided in the instances where current statutes do not prescribe the specific retirement benefits;

  2) remove asset management functions from the control of individual local governments and give it to one retirement board controlled by local government members; and

  3) eventually preclude utilization of local service providers for actuarial, insurance, consulting, legal, banking and management functions.

- The implementation of a statewide local government retirement system is a step toward "big "government" and any activity managed at the state level is suspect because:

  1) state government is less efficient than local government;

  2) the interests reflected by state policy makers are divergent and may not be consistent with local government needs; and

  3) there is the potential for hidden provisions to permit a "bailout" of some municipalities or the State at the expense of other municipalities.

- The statewide local government retirement system would:

  1) potentially complicate the provision of employee retirement benefits during the transitional period;

  2) ultimately cost more than current local retirement systems even though before-the-fact estimates indicate to the contrary; and

  3) be fixing a problem where none exists.

Part II
Pension Portability

Background

Pennsylvania has approximately 973 municipal police pension plans, 918 with defined benefits and 55 without defined benefits. They range from 6,597 active members to 1 active member. Over half of the pension plans (528) have less than 5 active members.

Portability

Other than mandating a statewide change to defined contribution pension plans, pension portability can best be achieved for municipal police officers through the establishment of one cost-sharing, multiple-employer, defined benefit retirement plan. This approach is evident in the State Employes' Retirement System, which provides for portability among 107 state related employers, and the Public School Employes' Retirement System, which provides for portability among 640 public school employers. Because employee movement would be within one retirement system with standard actuarial methodology and benefits, there is no potential for the inequity that is inherent with the alternative approaches. The alternative approaches, which endeavor to provide portability within the existing local systems, are extremely complex administratively and have substantial potential for employer and employee inequity. The complexity and inequity result because the alternative approaches must 1) accommodate over 900 separate pension plans with a myriad of benefit designs, 2) effect asset transfers calculated with varying actuarial methodologies and 3) operate without a coordinating administrative structure for the required inter-municipal transactions.

Advantages	Disadvantages
More nearly establishes a free market for labor.	Reduces ability of municipalities to retain personnel.
Provides improved access to experienced personnel.	Produces loss of trained and experienced police officers.
Reduces recruiting and training costs for municipalities hiring employees.	Increases of recruiting and training costs for municipalities losing employees, and may shift training costs, in the aggregate, from larger municipalities to smaller ones.
Provides increased opportunity for career advancement of police officers	Actuarial gains currently achieved through employee terminations prior to vesting availability will be eliminated.

Alternative Approaches To Effect Portability Among The Over 900 Local Retirement Plans

- Service Credit Transfer Approach - provides for the service credit of the employee to be transferred from the old employer to the new employer on a year-for-year basis and requires the transfer of assets equal to the actuarially calculated value of the service credit in the old pension plan to the new pension plan. The assets transferred may be more or less than the liabilities incurred by the new employer, due to variations in benefits and/or actuarial methodology. The dollar value of the benefits provided to the employee by virtue of the transferred service credit may be more or less than would have been provided under old pension plan, due to variations in benefits.

- Benefit Earned Transfer Approach - provides for assets equal to the value of the benefit earned in the pension plan of the old employer to be transferred to the pension plan of the new employer, with the employee receiving whatever service credit in the new pension plan that the transferred assets can 'purchase'. If actuarial calculation are correctly performed and accurate, the assets transferred will equal the liabilities removed from the old pension plan as well as those incurred by the new pension plan. The amount of service credit the employee receives in the new pension plan will be more or less than the amount of service credited under the old pension plan. There is a risk of gain or loss, both to the old and new pension plans and to the employee, due to variations or errors in actuarial methodologies.

Disadvantages Of Alternative Approaches

- The multitude of pay scales, benefit structures, actuarial assumptions and other factors impacting the calculations required to make the required asset transfers will produce ongoing inequities for municipalities and employees. (Example: Two identical employees in two different municipalities could transfer to a third municipality and be given different service credits.)

- The lack of an administrative mechanism to coordinate the data and asset transfers between municipalities will only be addressed through recurring judicial involvement, with no assured consistency of policy on a statewide basis.

- In the Service Credit Transfer Approach, the assets of a defined benefit pension plan will be insufficient to make the required transfer if the pension plan is small and under funded. Should the municipalities be required to use general fund monies to make the required transfer?

- The potential need for asset transfers will necessitate more conservative investments to accommodate cash flow needs, due to the small size of most municipal pension plans.

- The two actuarial calculations needed for each instance of pension portability will increase administrative costs. Since the employee and the municipalities will need to know the calculations before the employment decision is finalized, these costs will be incurred even when no portability is exercised.

- Because of the variable competency of municipal actuaries and the difficulty of ensuring a consistent methodology with multiple actuaries, errors in calculating the service credits and asset transfers will be made that will be difficult or impossible to rectify afterwards.

- Due to the likelihood of manipulation by municipalities, there will be a need to specify the actuarial assumptions to be used in the portability calculations. Standard actuarial assumptions will produce an additional source of gains or losses for almost all municipalities since the standard assumptions will not match their actual experience.

- In the case of portability between pension plans without defined benefits, there is no problem. However, if the old pension plan has no defined benefits and the new pension plan has defined benefits, Service Credit Transfer Approach requires an asset transfer but the amount of the asset transfer can not be determined by evaluating the old pension plan's benefit structure. Using the accumulated account value will result in an asset transfer that is either less than or more than the value of the service credited in the new pension plan, and the treatment of the total transferred assets as anything other than employee contributions may be prohibited.