MOCKENHAUPT BENEFITS GROUP

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Spring 2002

Public Employee Benefit Review

Mockenhaupt Benefits Group - Ready to Serve You

For over 40 years, Mockenhaupt Benefits Group has been dedicated to the business of public employee benefits. We provide consulting services to over 400 municipal retirement plans in Pennsylvania. Our consultants are more experienced in dealing with municipal pension plan issues than any other actuarial/consulting firm in the state. We welcome questions, from the most basic to the very complex plan design, compliance or funding inquiries. Our mission is to provide our clients the support they need in administering their pension plans, and doing it with a personal touch. We are also committed to keeping you up-to-date on the changing environment of governmental pension plans, including legislative changes and other current events.

Pictured left are Mockenhaupt Benefits Group staff including:
Seated (l-r): Eileen Mirt, Bill Asay, Diane Sokol & Herb Loomis
Standing (l-r): Carrie Parks, Dean Ross, Colleen Deer, Joe Forbes, Barrie Viglio & Chris Anderson
Not pictured: Tammy Coen

Governor signs Senate Bill 16 amending Act 600

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On April 17, 2002, Governor Schweiker signed Senate Bill 16, now known as Act 30 of 2002, amending the provisions of Act 600 of 1956, the Municipal Police Pension Law. Changes in this amendment include new mandatory benefits, which will need to be taken into consideration in the collective bargaining process in the near future. The law became effective immediately.

The amendment includes changes to the following provisions of Act 600 police pension plans:

1. **Surviving Spouse Benefits (*after retirement eligibility*)**
2. **Pre-Retirement Death Benefit**
3. **Disability Benefits**
4. **Killed-in-Service Benefits**
5. **Employee Contributions**

Surviving Spouse Benefits

Prior to this amendment, Act 600 provided an optional surviving spouse benefit. If an officer died after retirement, or after becoming eligible to retire, the spouse could receive a monthly benefit of 50 percent of the amount the retiree was receiving or was entitled to receive until death or remarriage. If there was no spouse, or if the spouse subsequently died or remarried, the survivor benefit would be paid to any children of the officer until they reached age 18.

Act 30 changes this provision in several ways. The surviving spouse benefit is now mandatory and sets 50 percent of the retiree's benefit as the minimum survivor benefit. It also allows payments to continue to the spouse for life, regardless of whether he or she remarries. If the benefit becomes payable to the children, payments may now continue until age 23 if the child is attending college.

Plans that currently have no surviving spouse benefit will have to add one. For plans with one already in place, we would expect that bargaining units will look to negotiate an increased survivor benefit, since the amendment opens the door for survivor benefits in excess of 50 percent.

Pre-Retirement Death Benefit

Previously, the widow of a deceased officer would only receive a survivor benefit if the officer died after attaining normal or early retirement age. If an officer died before then, his beneficiary would be paid a refund of his employee contributions, plus interest. Refunds will now automatically be paid to the spouse, or if there is no spouse, to the dependent children, unless the officer designated another beneficiary. It seems this change was made to guarantee that the refund would be paid to the officer's spouse or family in the absence of a designation.

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SENATE BILL 16

It is also important to note that the amendment specifically states that this death benefit applies to members that die prior to becoming vested. So, while the legislation doesn't explicitly expand the surviving spouse benefit (*described above*), it may be inferred that since the pre-vesting death benefit is part of the same section as the surviving spouse benefit, by default the spouse of a vested member who dies would be treated the same as the spouse of an officer who is retired, or eligible to retire.

Disability Benefit

Service-connected disability benefits have been a mandatory provision of Act 600, but the amount of the benefit was determined by the governing body or through negotiations. The amendment requires disability benefits to be "no less than 50 percent of the member's salary at the time the disability occurs." The Act refers to "salary" and not "monthly average salary" as used in the normal retirement benefit section. This may allow the salary used in the disability calculation to be different from the normal retirement calculation. Also, an offset may be applied to the pension benefit for social security disability benefits.

Plans with disability benefit levels below 50 percent of salary will have to be amended. Consideration of increasing disability benefits to levels over 50 percent should be made with caution. Before adopting a greater disability benefit, municipalities should have the plan actuary prepare a study of various percentages, including hypothetical scenarios that demonstrate the impact of an actual disability claim at that level. Disability retirements usually create significant actuarial losses in small to medium plans, especially when benefit amounts exceed the normal retirement benefit.

Killed-in-Service Benefit

Act 600 previously allowed for the voluntary adoption of a killed-in-service provision where the benefit level was set by the governing body. Now, plans will not only be required to provide a killed in service benefit, but the amount must be 100 percent of the member's salary, which is two times or more the amount of a normal retirement benefit. The benefit is payable to the family of the officer, presumably, in the same manner as the surviving spouse benefit.

The probability of a police officer being killed-in-service is, thankfully, low. Therefore, the pre-funding effect on the annual cost would typically be minimal. However, at the levels mandated by this act, if a married police officer was killed in the line of duty, it could have a devastating effect on the funding levels of the plan, especially if the plan is small or not extremely well funded. We would strongly suggest that the governing body investigate the possibility of insuring this risk. The premium for such coverage should be very low and will help to protect the plan in the unfortunate event of an actual claim.

Employee Contributions

Historically, member contributions in Act 600 plans have been the topic of many contract negotiations with much debate over the interpretation of the statutory prerequisites for reducing or eliminating the contributions. Under Act 600, a municipality could only reduce contributions on an annual basis if:

1. *An actuarial study shows that the contributions would not be required to keep the fund actuarially sound,*
2. *A resolution or ordinance is passed by the governing body, and*
3. *If contributions are reduced or eliminated, no contribution will be required from the municipality's general fund.*

Act 30 eliminates the requirement for an annual actuarial study. Also, contributions may now be reduced or eliminated even if the municipality is required to contribute, but the governing body will continue to be required to pass an annual ordinance or resolution. Note that the language still makes eliminating or reducing contributions a discretionary choice of the governing body, however, many municipalities have allowed this provision to be viewed as a benefit of the plan, and thus a subject of collective bargaining.

While an annual actuarial study is no longer required, it would be advisable for municipalities to review the reduction or elimination of employee contributions with the plan actuary, especially with regard to the effect on state aid.

Documentation and Formal Adoption

Changes resulting from the passage of this Act will constitute a formal change to the pension plan provisions. You may need to amend your municipal pension plan document and/or ordinance. You may also need to incorporate some changes in your collective bargaining agreement, or at least include them by reference to the document or statute.

Summary

This amendment provides many ancillary benefit enhancements, both mandatory and optional, which benefit the members. It has been many years since Act 600 has undergone such extensive changes. Each municipality sponsoring a police plan governed by Act 600 should review Act 30 with their solicitor and pension consultant to determine which of their plan's provisions may need to be amended and what the actuarial cost impact will be. Also, municipalities should determine the effect these changes will have on collective bargaining, state aid revenues and general fund revenues. If municipal officials do not evaluate and understand the potential cost implications of this amendment, they may find themselves unprepared for future funding increases.

If you have concerns about how these changes will impact your municipality's police pension plan, contact a Mockenhaupt Benefits Group consultant.

Mockenhaupt Benefits Group is committed to making a difference for you.

RESPONSE

Auditor General Provides Update in Regard to Excess Benefits

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In an effort to clarify its stance and respond to comments on its Municipal Pension Bulletin No. 2001-01 Unauthorized, or Excess Benefits, the Department of the Auditor General issued a memorandum to municipal officials and attorneys in March 2002. The original Bulletin was issued on July 1, 2001 and was featured in our Fall 2001 newsletter.

The Department issued the memorandum responding to inquiries and concerns from various attorneys representing employee unions and municipalities regarding lump-sum payments in pension benefits, excess benefits in pension plans and its application of the decision in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee* to home rule municipalities.

Specifically, the Department responded to questions from attorneys for the Fraternal Order of Police in regard to lump-sum payments. It also addressed an article authored by two attorneys, *"A Practical Approach to the Auditor General's Bulletin on Excess Pension Benefits,"* which appeared in the November edition of the Borough News also questioning the Department's lump-sum payment policy and other portions of the Bulletin.

In its memorandum, the Department arranged information into three areas: how the Department will handle excess benefits in general, a modification of its position on the inclusion of lump-sum payments in benefit calculations, and further comment on the *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee* ruling.

Excess Benefits

The Department refers to benefits that are not specifically permitted by enabling statutes, such as Act 600 or the Third Class City Code, as excess benefits. The Department's position on excess benefits is fairly simple. Excess benefits must be included in the annual Minimum Municipal Obligation calculations, as required by Act 205 of 1984. State aid can not be provided to pay for excess benefits; therefore, a municipality must pay that portion of the Minimum Municipal Obligation arising from excess benefits.

Part of the memorandum discusses the problems municipalities may encounter in bringing their pension plans into compliance with the enabling statutes. Collective bargaining agreements, unappealed arbitration decisions and the existence of vested rights limit the ability of a municipality to discontinue providing excess benefits. The Department does not expect municipalities to disregard collective bargaining agreements or ordinances that grant excess pension benefits. Legally, the Department says that it cannot condone or encourage the provision of unauthorized benefits through state aid subsidization.

The Department's current solution to the problem of excess benefits is to not provide state aid to pay for any excess benefit. In the past, the solution would have been that a municipality could not receive any pension state aid if any of its plans contained excess benefits.

In Bulletin No. 2001-01, the Department offered grace periods for municipalities to conform pension benefits to governing law. Municipalities with enforceable collective bargaining agreements in effect on the date of the Bulletin (*July 1, 2001*) must eliminate excess benefits on the effective date of the subsequent bargaining agreement. Municipalities cannot extend or renew existing bargaining agreements to avoid compliance. If there was an ordinance in place on the Bulletin's issue date containing excess benefits, but no collective bargaining agreement, the benefits had to be eliminated within 90 days of the Bulletin's issue.

EXCESS BENEFITS

Municipalities not achieving compliance by the end of the grace period will probably receive an audit finding that will lead to not being able to receive state aid for excess benefits.

Lump-Sum Payments Relating to Excess Benefits

The Department feels that its position on lump-sum payments is not as uncompromising as one may think. In fact, it admits that additional clarification is needed on this issue (*from its original bulletin*) and that the potential for inconsistent treatment needs to be eliminated. In light of this, there is now no objection to a municipality including accumulated unused leave in pension calculations as long as the leave was earned during the applicable pension computation period. This is a change from the original Bulletin.

Any unused leave (*such as vacation, sick and personal leave*) that is earned during the compensation averaging period and paid as a lump-sum at retirement can be included in the calculation of benefits. For example, suppose that an employee who never used sick leave earned five sick days per year and could receive a lump sum payment for a maximum of 30 unused sick days at retirement. If the pension plan uses average pay during the final three years of employment to determine benefits, 15 days (*five days per year times three years*) of unused sick leave could be included in the pension calculation. The employee would be paid for all 30 days of unused leave, but only 15 days could be included in calculating the pension. In this example, including more than 15 days of leave in the pension calculation could result in a finding that the plan provided excess benefits.

The Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee Ruling

The Monroeville decision caused one exception to the Department's position on excess benefits. There is no excess benefits penalty for benefits paid to employees of home rule municipalities who started full time employment before Jan. 24, 2001 as long as the excess benefits were part of the pension plan by that date. Any excess benefits granted to home rule employees on or after Jan. 24, 2001 or to employees hired on or after that date could result in a finding that excess benefits were being paid.

The Department states that it will not challenge a decision of a home rule municipality that concludes it's legally bound to provide excess benefits to employees who began work on or after Jan. 24, 2001. However, it does expect home rule municipalities to bear the cost of excess benefits.

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MOCKENHAUPT BENEFITS GROUP

Specializing in Municipal Benefit Consulting and Actuarial Services

DROPs

Public Employee Retirement Commission

Releases a Special Report on DROP Plans

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Many local governments may soon be hearing more about a program affecting their employees' retirement benefits - DROPs (*Deferred Retirement Option Plans*).

While these plans have been very popular in the south since the early 1980's, they are now becoming widely adopted throughout the country.

As outlined in our Summer 1999 issue of the PEBR, DROPs will allow those eligible for retirement to continue to work for an agreed upon period of time without losing the retirement benefits they would have otherwise been paid if they were retired. An employee could make an election to enter DROP status after becoming eligible to retire and would be treated for pension plan purposes as if he or she was retired.

Instead of payments being made from the plan to the employee, the regular monthly retirement payments would be accumulated in the pension fund and credited with interest until the end of the DROP period. When the DROP period ends, which coincides with the conclusion of active employment, the employee would begin to receive his/her normal monthly pension benefits (*as calculated when entering DROP*) and also be paid a lump-sum amount representing the retirement benefits earned during the DROP period, plus interest.

The idea for the DROP program came about because of the many governmental plans (*primarily police and firefighter plans*), where the accrual of additional pension benefits beyond normal retirement eligibility is very small due to a cap on the monthly benefit of 50 percent of average pay. Employees choosing to continue working past retirement eligibility forgo the pension they could have been collecting, but gain only a small increase to the benefit they ultimately receive when they do retire.

This idea has started to catch on in Pennsylvania and a number of municipalities are either already operating a DROP program or have recently established one. The reason why many more DROPs haven't been implemented is because the statutes governing the vast majority of the plans most suited to a DROP provision, do not currently permit such an option. Act 600 limits the benefits and options that can be provided to police plans of boroughs and townships with three or more full-time officers. In addition, the Third Class City Code limits benefits for police, fire and non-uniformed employee pension plans of Third Class Cities. Most of the DROP plans already in place are in optional charter cities, which in the opinion of the Department of the Auditor General, are not limited by the provisions of the Third Class City Code.

In March 2002, the Public Employee Retirement Commission (*PERC*) issued a Special Report on Deferred Retirement Option Plans (*DROPS*) and presented it to the Governor and members of the General Assembly.

Specifically, PERC is recommending that:

- The General Assembly enact statewide legislation specifically authorizing DROP programs by Pennsylvania local governments.
- A single, uniform, statewide DROP program be authorized for all Pennsylvania local governments.
- DROP participants be considered retired for all purposes and that the nomenclature for DROPs be cited and referred to as In-Service Retirement Option Plans (*IROPs*).
- Standard IROP plan design features be set up through an amendment to Act 205 of 1984.

Note that the DROP, as proposed by PERC, would only be an optional benefit provision. And, like any other optional benefit being considered by a municipal pension plan in Pennsylvania, an actuarial study must be performed prior to enactment, to determine the financial impact of the change.

It would appear that the Public Employee Retirement Commission's interest in supporting legislation and guidance on DROP plans is the first step in eliminating the current barrier to adopting DROP plans for many local governments in Pennsylvania. If your municipality is considering a DROP program for any of the pension plans it sponsors, you would be well advised to take into consideration not only the current statutory limitations, but also how the specific features of the DROP compare to those proposed by PERC.

Watch for our next issue where we will feature specific details of proposed DROP plan provisions.

Reminders/Deadlines for Remainder of 2002

September 1	(approx.)	Act 147 (ad hoc COLA) reimbursement checks mailed
September 30		2003 MMOs must be submitted to the governing body
October 1	(approx.)	State aid checks for 2002 will be mailed
October 31	(approx.)	State aid must be deposited to pension funds (30 days after receipt)
December 31		2002 MMO deposit due

Mockenhaupt Benefits Group Conference Schedule

Look for our consultants at these upcoming conferences:

GFOA - May	PSAB - June
APMM - May	PLCM - June

LEGISLATION

UPDATE

Pending Pension Legislation

House Bill 1360

Summary – Provides mandated ad hoc cost-of-living increases to police and firefighter retirees who retired before Jan. 1, 1996. Increases would be calculated based on a combination of years of service with the municipality and years on retirement. Reimbursements by the state would be in relation to the impact of the increases on the municipality's minimum municipal obligation (*MMO*), if any. The reimbursements would be paid from the pool of General Municipal Pension System State Aid prior to the allocation for normal pension costs.

Bill Status – Passed by House on June 20, 2001; referred to Senate Finance Committee on June 21, 2001; reported for First Consideration on Dec. 11, 2001; re-referred to Appropriations Committee on Dec. 12, 2001.

House Bill 1363

Summary – Allows Third Class Cities to increase the cap on service increment benefits for firefighters and police officers from $100 to $500. The bill also contains language to allow pension benefits to exceed 50 percent of salary for firefighters and police officers under certain circumstances.

Bill Status – Passed by House on June 20, 2001; Referred to Senate Finance Committee on June 21, 2001; Reported as amended for First Consideration on Dec. 11, 2001; Re-referred to Appropriations Committee on Dec. 12, 2001.

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