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Summer 2008

Public Employee Benefit Review

IRS Renews Interest in Government Pension Plans...

Sponsors Governmental Plans Roundtable - April 22, 2008

By William C. Asay, CEBS
President
(412) 394-9332
bill.asay@MBGbenefits.com

For many years, the federal government has taken a hands-off approach to government pension plans, except in the most egregious circumstances. *However, this is now changing...*it all began with a meeting on April 22, 2008 when the IRS hosted a roundtable discussion with representatives from the governmental plans community designed to raise awareness of the need for plan sponsors to comply with the tax qualification requirements of the Internal Revenue Code (IRC) and other federal statutes.

The Bureau of National Affairs reported that **Steven Miller**, commissioner of the IRS Tax Exempt and Government Entities Division, said that ***the Internal Revenue Service intends to increase its scrutiny of government pension plans***. He also said that government plans have been "underserved by the IRS" and that the agency now intends to systematically review them.

Other issues discussed included:

- Timely amendment requirements and the Voluntary Compliance Program under the new staggered remedial amendment program.
- How the IRS Voluntary Compliance Program can help you find, fix and avoid errors.
- IRC enforcement efforts.
- Technical and compliance issues.
- Assisting government plans in achieving compliance.

The IRS conceded that it had very little history in the examination of government plans. So, its intent is to "evolve into compliance." It will be sending 20 - 39 questionnaires to plan representatives by this summer; and, based on the results, a more comprehensive questionnaire will be created and sent to 200 plan representatives in 2009. Questionnaire information will not be held against plan representatives; but, a failure to reply could open a compliance check by the IRS.

All government pension plans, including Pennsylvania's approximate 3,000 of the almost 9,000 nationwide, are required to comply with the applicable provisions of the Internal Revenue Code. *(A further explanation of the IRC plan provision requirements for government plans can be viewed on our Web site at www.mockenhauptbenefits.com. The qualification topic was discussed in the Fall and Winter 2006 newsletters.)*

By complying with the various IRS requirements and regulations, individual pension plans would be "tax qualified." The municipality may request a Determination Letter from the IRS that would guarantee that the plan has been reviewed by them and complied with all federal requirements. But, under normal circumstances, a Determination Letter may only be requested during the Filing Cycle C, from Feb. 1, 2008 – Jan. 1, 2009. After the close of this cycle, the next opportunity will begin in 2013.

Therefore, if the plan is "tax qualified," the municipality would be able to avoid the potential penalty of withholding taxes on the participant accrued benefits should the IRS deem the plan not qualified. This potential penalty could cause the municipality many problems and great harm, including collective bargaining and the general fund issues.

It is the responsibility and fiduciary duty of every governing body sponsoring a pension plan to comply with state and federal regulations.

Municipal Pension Plans in Pennsylvania

There are many pension plan vendors in Pennsylvania. Some provide you with turnkey approaches to pension administration and many more will provide you with services on a single product basis, leaving municipal administrators to pull all the pieces together. Some municipalities use their actuaries/consultants to help guide them, and some add the services of an attorney in the administration of their pension plans. However you do it, most municipalities could have problems complying with IRS regulations for government plans.

Many Pennsylvania municipal officials have taken the position that all they need to do is comply with the various state statutes to receive a clean audit report from the Department of the Auditor General, and all would be fine. This couldn't be further from the truth. The Auditor General is charged with implementing the state requirements and **does not** review the federal requirements. Unlike corporate plans that must comply primarily with the Employee Retirement Income Security Act (ERISA), and other subsequent legislation, government plans must comply with both federal and state laws. Sometimes these laws conflict with one another.

Solution

Compliance with IRS governmental pension plans has been the municipality's responsibility for over 30 years. There have been some vendors, actuaries/consultants and attorneys in Pennsylvania who've helped their clients comply. Many have not. If your plan documents have not been updated or restated recently for current federal legislation, you may have problems with IRS compliance requirements. Discuss your situation with your pension advisor as soon as possible and take the necessary steps to avoid any problems with the IRS.

Commonwealth Court Allows Stocks and Bonds to Be Used to Fund OPEB, But...

By Dean Ross
Senior Consultant
(412) 394-9344
dean.ross@MBGbenefits.com

A trust established to fund a municipality's Postemployment Benefits Other than Pensions (OPEB) can now invest in stocks and bonds. This ability came from an opinion issued by Commonwealth Court this past March 17 in *J.A. Danzilli, Jr., et al. v. J. Lomeo, et al*. and was based on Act 205 of 1984 *(Municipal Pension Plan Funding Standard and Recovery Act)* along with prior court decisions.

While the ability to invest in stocks and bonds is good news, the reliance on Act 205 has raised questions.

The Issue

As discussed in the opinion and footnotes, Article 9 §9 of the Pennsylvania Constitution prevents the General Assembly from authorizing a municipality to invest in corporate stocks and bonds. However, a trust established by a municipality to fund a municipal pension or retirement plan may invest in stocks and bonds. So the question becomes does a trust used to fund OPEB benefits belong to a municipality, or is it a trust funding a municipal pension or retirement plan?

To define a "municipal pension plan" or a "retirement plan," Commonwealth Court looked to Pennsylvania Act 205 of 1984. Their opinion concluded that, "Based on the statutory definitions contained in the Municipal Pension Plan Funding Standard and Recovery Act and because post-retirement medical benefits have been consistently interpreted to be retirement or pension benefits, the Trust created to fund those benefits is a pension or retirement plan under 20 Pa. C.S. §7301, and the fiduciary may invest those funds as authorized by Chapter 73 of the PEF Code." *(The PEF is the Pennsylvania Probate, Estates and Fiduciaries Code 20 Pa. C.S. §§7301-7319.)*

Therefore, Commonwealth Court has determined that OPEB trusts are permitted to invest in stocks and bonds.

Good News for Municipalities Choosing to Pre-Fund OPEB Benefits

As discussed in our Winter 2005 Newsletter (you can read it online at **www.mockenhauptbenefits.com**), Governmental Accounting Standards Board Statement #45 controls the reporting and disclosure of OPEB liabilities and requires that they be determined using an interest rate reflecting the anticipated long-term rate of return on the fund.

If Commonwealth Court had not permitted OPEB trusts to invest in stocks and bonds, a lower interest rate *(similar to the expected return on six month treasury bills)* would be used to determine liabilities. A lower interest rate produces a higher present value of future liabilities; and, a higher liability requires a greater annual required contribution to fund the benefits.

A trust investing in stocks and bonds can be assumed to have a higher long term rate of return *(similar to the rates assumed for pension plan valuations)*. A higher assumed rate of return means a lower present value of liabilities and annual required contribution. Municipalities that pre-fund OPEB liabilities using stocks and bonds will have lower contribution requirements.

The Commonwealth Court ruling is only one of a number of factors that a municipality should consider when determining if the OPEB liabilities should be pre-funded. For municipalities choosing to pre-fund, the ruling provides a greater range of investment options, each impacting the annual required contribution.

But...

While this case has allowed greater flexibility for investing OPEB trust funds, it also raises other questions:

- The opinion mentions post-retirement healthcare and medical benefits. It does not mention other common types of post-retirement benefits such as life insurance. Does the opinion extend to these benefits as well?
- Because of the opinion's reliance on Act 205, some people are questioning whether OPEB plans are now subject to Act 205 with its specific funding requirements that are different from Statement #45's requirements. If this is the case, some municipalities would have much higher funding requirements under Act 205 than under Statement #45. Others feel that this opinion does not subject OPEB plans to Act 205 requirements. Another court decision or legislation may be needed to settle the issue.

Conclusion

Municipalities pre-funding the OPEB liability now have the ability to invest in stocks and bonds. As a result, annual contribution requirements could be lower. However, as recent experience with pension plans has shown, investing in stocks and bonds can lead to greater year to year variation in the annual plan contribution.

New HEART Act Provides Enhanced Benefits to Military Service Personnel

On June 17, President Bush signed the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 into law providing tax breaks and other benefits to military service personnel and their families; ***this Act will require action to be taken by sponsors of qualified retirement plans.***

The Act enables a plan participant's survivors to receive a larger benefit than they would have prior to it being passed. The HEART Act calls for sponsors to amend their qualified retirement plans to provide additional benefits to survivors of participants who die while performing qualified military service. It modifies the Uniformed Services Employment and Re-employment Rights (USERRA) Act now allowing the day prior to the date of a service person's death to be treated as the date he or she returned to work *(for purposes of triggering survivor benefits payments under a qualified retirement plan)*.

The law also makes special rules permitting penalty-free withdrawals from retirement plans permanent.

To find out how the HEART Act affects your plan, call your Mockenhaupt Benefits Group consultant at (800) 405-3620.

Notes from the MEIT

Municipal Employers Insurance Trust

By joining forces with the MEIT *(Municipal Employers Insurance Trust)*...
we provide group insurance products at the lowest cost to our clients.

For almost 40 years, over 500 clients have trusted us to meet their insurance needs. MEIT is a fully insured multiple employer group insurance trust specializing in the unique needs of municipalities, authorities and councils of government throughout Pennsylvania.

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- Term & Paid-up Life Insurance
- Vision Plans and Dental Plans
- Killed-in-Service Insurance Policy

Poll Finds that Medical Costs will Increase Worldwide Over the Next Five Years

Medical costs in Pennsylvania have dramatically increased making many of us wonder if there is an end in sight. Is the United States the only country getting hit with ever increasing healthcare costs?

Watson Wyatt Worldwide conducted a poll of insurance companies and found that in a vast majority of countries, medical cost increases are outpacing the general rate of inflation. Watson Wyatt surveyed 81 insurance companies providing medical insurance to employers in the Americas, Europe, Asia and Africa. Seventy-one percent of the respondents expect higher or significantly higher medical trends over the next five years. Eighty-one percent reported that medical costs are higher than their general inflation rate.

Factors causing significant cost increases in the United States *(such as an aging population, increased utilization and expensive technology)* are causing the same results worldwide.

Global Medical Cost Trends

(As stated in a Feb. 6, 2008 news release from Watson Wyatt)

	2006	2007	2008 (projected)
Asia & Africa			
China	15.2%	21.2%	19.6%
Hong Kong	6.8%	8.8%	9.1%
Philippines	11.6%	11.4%	11.5%
Russia	13.3%	13.7%	15.7%
Saudi Arabia	13.3%	13.3%	16.3%
Singapore	5.5%	6.5%	7.5%
South Africa	7.4%	10.0%	12.6%
Europe			
France	5.6%	6.6%	7.3%
Italy	5.5%	11.0%	11.3%
Netherlands	6.0%	5.2%	6.0%
Switzerland	3.8%	7.5%	6.0%
United Kingdom	6.0%	8.0%	8.0%
Americas			
Brazil	9.2%	5.9%	7.2%
Canada	12.3%	11.5%	12.0%
Chile	5.8%	6.5%	7.1%
Mexico	12.0%	12.8%	12.6%
United States	8.3%	8.0%	11.0%
Venezuela	31.3%	25.0%	25.0%

Based on this poll, it appears that most insurance companies surveyed believe that medical cost trends will continue to grow faster than inflation. It will continue to be important to determine how these cost trends will equate to your healthcare premiums and your GASB 43 and 45 liabilities in the future.

Let us go to work for you...

To learn more about the MEIT or our many benefit plans, contact:

Tammy Cappo
MEIT Client Manager
e-mail: tammy.cappo@MBGbenefits.com
1-800-405-3620
www.mockenhauptbenefits.com

MEIT*...Serving Government Clients for Four Decades.*

What a Great Idea!

The Municipality of Mt. Lebanon sponsored a benefits fair at its recreation center on May 16 for all full time employees and their spouses. Representatives from the Municipality's various benefits vendors were invited to set up a table and answer employee questions, as well as provide an opportunity for employees to enroll in voluntary programs.

Employees were able to receive information about flexible spending accounts, medical insurance, vision, credit union, life insurance, pension plans, long-term disability insurance, voluntary insurances, deferred compensation, employee assistance program, and workers' compensation.

The fair, organized by the Municipality's Safety Committee, was held from 11 a.m. - 2 p.m. enabling employees to attend on their lunch breaks. Members of the fire department handled the grill work for chicken, burgers and sausages. The Municipality covered all food and beverage costs.

Municipal officials considered the fair a success with about half of their 131 full time employees participating from the Police Department, Fire Department, Public Works, Library, Recreation and Office staff. **Chris Anderson** and **Colleen Deer** manned the pension plan table and **Tammy Cappo** was on-site representing the Municipal Employers Insurance Trust (MEIT) to answer questions about health care benefits.

Reminders/Deadlines for the Remainder of 2008

Sept. 1 (*approx.*): ....Act 147 (*1989 ad hoc COLA*) reimbursement checks mailed.
Sept. 30: ....2009 MMOs must be submitted to the governing body.
Oct. 1 (*approx.*): ......State aid checks for 2008 will be mailed.
Act 64 (*2002 ad hoc COLA*) reimbursement checks mailed.
Oct. 31 (*approx.*): ....State aid must be deposited to pension funds (*30 days after receipt*).
Dec. 31: ....2008 MMO deposit is due.

Check on pending pension legislation and other important news, or download prior issues of the PEBR from our Web site at www.mockenhauptbenefits.com. The Client Login section allows clients to download recent reports and MMOs, maintain client information, and identify then download the forms needed to administer their plans.

Legislative Update

Statewide Local Police Pension System - Senate Bill No. 596 would require all newly hired local government police officers to participate in the state employees' retirement system (SERS). Existing police pension plans could transfer in under certain circumstances. This bill has had its first consideration in the Senate and was re-referred to the Senate Finance Committee on March 10, 2008.

DROP Legislation Activity - The DROP (or IROP) bill, which died at the end of the 2005/2006 legislative session (for the third time), was reintroduced on March 9, 2007 as House Bill No. 719. This bill has been referred to the House Finance Committee.

Survivor Benefits in Act 600 Plans – Senate Bill No. 1093 provides death benefits to survivors of retirees who retired prior to the passage of Act 30 of 2002, even if there were no plan survivor benefits at the time of retirement. The Senate passed this bill unanimously on May 14, 2008 and it has been referred to the Finance Committee in the House. This bill has had its first consideration in the House and has been re-referred to the Appropriations Committee.

Do you have a suggestion for an article for a future newsletter?
Call us at (800) 405-3620 or submit an e-mail through our Web site.

Contact Information

Mockenhaupt Benefits Group
Suite 1225, One Gateway Center
420 Fort Duquesne Blvd.
Pittsburgh, PA 15222

Toll Free Phone
1-800-405-3620

Local Phone
(412) 394-9660

Fax
(412) 394-6339

MOCKENHAUPT
BENEFITS GROUP

Specializing in Public Employee Benefit Consulting and Actuarial Services

MOCKENHAUPT
BENEFITS GROUP

Suite 1225
One Gateway Center
420 Fort Duquesne Blvd.
Pittsburgh, PA 15222
www.mockenhauptbenefits.com

Look for us in October at the 2008 GFOA-PA Fall Seminar,
Accounting, Actuarial and Investment Options for OPEBs

Oct. 1 – Camp Hill Borough Building
Oct. 3 – Cranberry Township Municipal Building
Oct. 10 – Towamencin Municipal Building

Colleen Deer will be speaking about the actuarial aspect of OPEBs.