

**Testimony of Steve Vaughn**  
**Secretary, Pennsylvania Municipal Retirement System**  
**Joint Committee on Municipal Pensions**  
**January 22, 2018**

Good morning Chairs and Committee Members. On behalf of PMRS, I appreciate the opportunity to offer our comments on the proposed legislation and on municipal pension reform in general. In addition, we will address PMRS legislative needs in relation to the anticipated changes in the municipal retirement plan landscape with the implementation of proposed legislation.

**PMRS Facts**

- PMRS currently administers over 1,000 plans with 825 local governments located in 64 counties.
- We have almost 16,000 plan participants: 9,100 active, 1,000 deferred vested, and 5,700 monthly payees. With these demographics, you can see our average plan size is approximately 15 participants.
- The most recent overall PMRS funding ratio on both an actuarial and market value basis is 100%
  - As of 1/1/2015 on an actuarial basis:
    - 2/3rds of PMRS plans were fully funded
    - 94% of PMRS plans had funding ratios 80% or greater
- As of June 30, 2017, PMRS's latest one-year gross investment return was 16.7%, ranking in the highest 5% of public pension plans with assets greater than one billion dollars. For year-end 2017, our estimated return will be in excess of 18%.
- This year, PMRS expects IRS approval of one of the few and most comprehensive volume submitter retirement plan document templates for governmental plans in the U.S.

For over 40 years, PMRS has had essentially one program for municipal retirement plans. We have no legislative authority to administer:

- 457(b) deferred compensation plans;
- 401(a) defined compensation plans;
- Act 600 uniform plans with disability standards different from that specified in the PMRL; and
- Plans with different actuarial assumptions than those required in the PMRL

We have been working hard to enhance our operations in order to have the ability and capacity to assist any and all municipal retirement plans based on the services they want and need. Along with the proposed legislation providing PMRS with the lowest funded plans in the Commonwealth, PMRS would like the opportunity to serve other municipal plans with standalone or multiple services ranging from basic plan administration to asset management.

Simply put, we are asking for the tools necessary to compete in the modern governmental retirement plan marketplace

### **Proposed Legislation**

We interpret the legislation as focusing on five significant concepts that appear to be broadly acceptable to both legislative bodies based on the draft legislation we have reviewed:

- For all but the highest funded plans, the legislation will:
  - Eliminate pensions/retirement plans from the collective bargaining process
  - Require new municipal police officers and firefighters (and possibly non-uniform employees) to participate in a new “standard pension plan” that is a defined benefit plan with a proscribed benefit formulas for retirement and disability; a stated normal retirement age and strict parameters for the definition of “Compensation” and “Final Average Salary”.
  - Establishes a specific retirement plan transfer mechanism (“portability”) for the new standard pension plan , making it easier for plan participants to transfer among commonwealth municipalities during their career.
- For all existing municipal retirement plans, the legislation will
  - Modify the Mandatory Municipal Obligation (MMO) formula to utilize the PMRS Regular Interest Rate to determine the annual plan funding costs.
  - Require plans, within a stated transition period, to modify their assumed rate of return to a level not to exceed the PMRS rate plus 1% for the purpose of determining actuarial funded levels
  - Increase oversight by the State Auditor for plan enhancement proposals and for the timely payments of required municipal funding obligations
  - Require municipalities to certify that it is using generally accepted accounting principles (GAAP) in accordance with the Governmental Accounting Standards Board (GASB) which is significant for broad acceptance and implementation of GASB 68 standards relating to the uniformity of retirement plan reporting in financial statements.
- Transfer existing and future pension plan management to PMRS for the most severely underfunded municipal plans (“severely distressed plans”)

- Prohibit Deferred Retirement Option Plans (DROPs) from being associated with the new standard pension plan and with existing retirement plans
- Allow plan sponsors the option to immediately increase their plan funding ratios through leveraging future State Aid allocations via bond proceeds

PMRS supports the goals and objectives that are identified in the legislation. Our experience illustrates that most plans can experience funding deterioration for three primary reasons:

- Governing authority approval of retroactive benefit enhancements including early retirement incentive windows or prospective benefit enhancements that significantly increase future normal costs
- Failure to make full payments recommended by plan actuaries and/or required under Commonwealth law, or
- Failure to implement realistic actuarial assumptions including assumed rates of investment returns, future salary increases, and updated mortality tables including disability experience, or

The proposed legislation addresses each of these three points. In particular, the legislation makes a significant effort to address items one and two through more intensive Auditor General oversight and limiting benefit enhancements for specified underfunded plans. While the current legislative draft does not address a broad range of actuarial assumptions, it does specifically focus on one of the most significant: the assumed investment rate of return.

Ultimately, a sound and sustainable defined benefit plan relies upon realistic actuarial assumptions that are periodically compared to actual plan experience and periodically modified to reflect that plan experience and demographic changes as they occur over time.

In looking at the details associated with the broad objectives of the legislation, PMRS would encourage some technical alterations that should not detract from the overall goals but would align specific provisions to current industry trends.

### **Summary**

Should PMRS be called upon to work with additional municipal retirement plans that have experienced and may be continue to experience funding challenges, we stand ready to assist. We hope that our request to provide PMRS with increased operational flexibility will be looked upon favorably to provide other available option to existing and future municipal retirement plans.

Finally, I, along with our counsel, look forward to discussing some technical changes are consistent with the modernizations contained in the legislation.

I will be happy to answer any questions you may have.