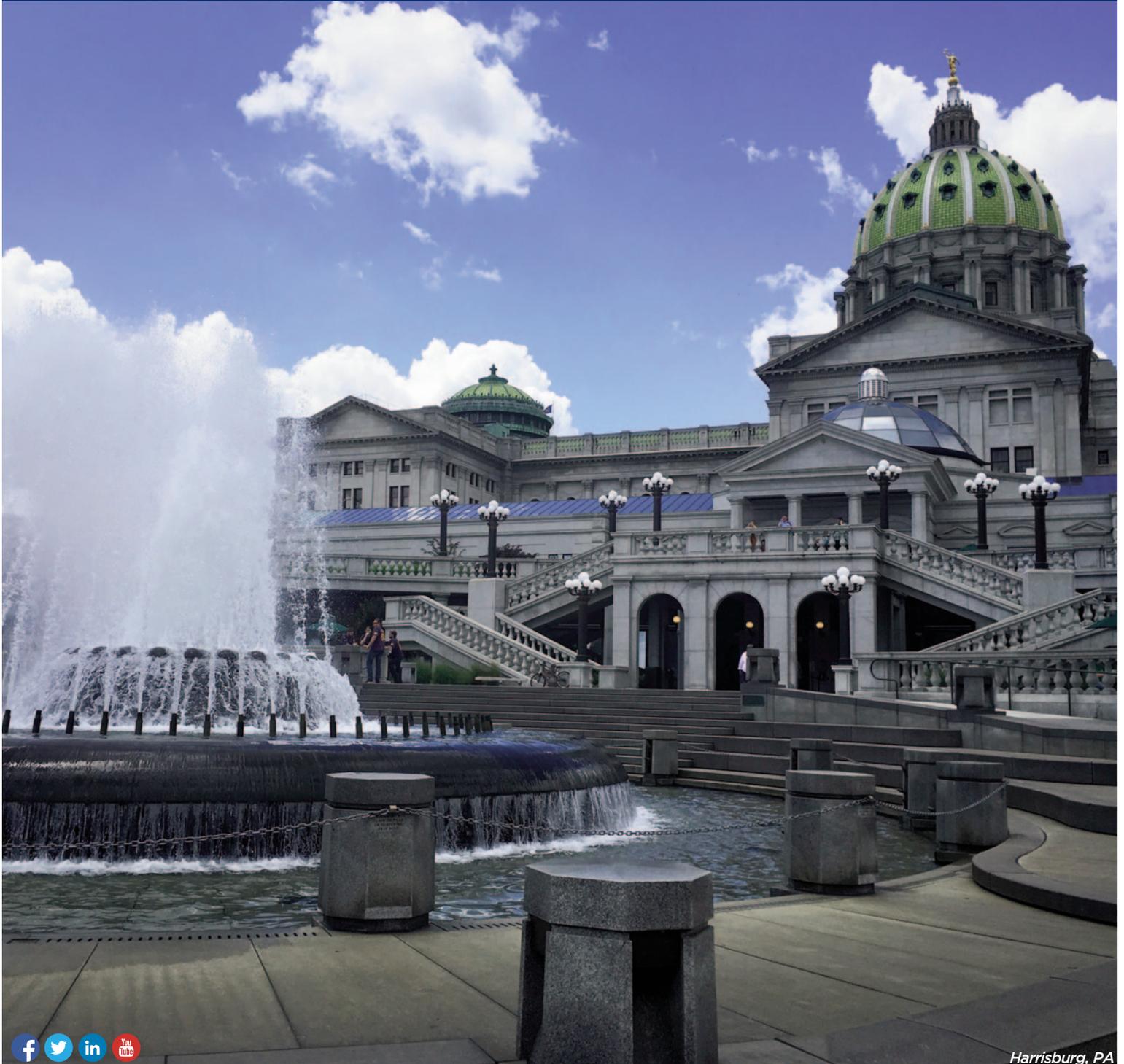


# MUNICIPAL PENSION HANDBOOK

Third Edition | August 2019



*Harrisburg, PA*

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Preparation of this publication was financed from appropriations of the General Assembly of the Commonwealth of Pennsylvania.

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# I. Introduction

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In an effort to provide ongoing financial security to their employees after their public service careers end, Pennsylvania municipalities and authorities sponsor approximately 3,240 pension plans, covering more than 136,900 active and retired police officers, firefighters, and non-uniformed or authority employees. *(There are even more when counties and school districts are considered!)* These plans (more than any other state) vary in number of members, benefit structure, and funding mechanism, resulting in a diverse pension realm unique to Pennsylvania.

Governing statutes vary depending upon the type of municipality sponsoring the plan. The Commonwealth's constitution, federal labor relations laws pertaining to union participation, and certain sections of the internal revenue code also impact pension plan provisions and administration.

Municipal pension plan sponsors, therefore, have diverse questions and issues they may need to resolve. This handbook presents general information about municipal pension plan structure, governing statutes, administration, and funding and reporting requirements. The information presented is based on legislation in effect at the time of publication and should not be solely relied upon to form any policy decisions.

*The Governor's Center for Local Government Services acknowledges the input and comments from Mockenhaupt Benefits Group.*

## II. Overview of Municipal Pension Plans

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### Reasons to Sponsor a Pension Plan

Local government entities may sponsor a pension plan for its employees for a number of reasons. Those commonly cited include the following:

- Reward employees for service to the municipality
- Attract desirable employees
- Retain employees
- Statutory compliance
- Utilize available state aid

A single government entity may sponsor multiple plans covering different groups of employees, or the same employees. The most commonly covered employee groups include police, paid firefighters, and non-uniformed employees. Records and actuarial and financial reports and filings must be maintained for each plan separately.

### Government Plans are Different than Private Plans

Government plans are exempt from the provisions of the Employee Retirement Income Security Act (ERISA), the major legislation governing private plans. However, some provisions of the Internal Revenue Code (IRC) do apply to government plans. The IRC provides the plan participant with special tax advantages and protections as long as the plan is considered “qualified” by meeting the requirements of Section 401(a) of the Code. In addition, as discussed throughout this publication, there are many state statutes that apply specifically to government plans.

### Constitutional Protection

The Pennsylvania Supreme Court has applied the state constitutional ban against the passage of laws that impair the obligation of contracts to the rights of public employees with regard to their pensions. Specifically, they’ve determined that pension benefits constitute a form of deferred compensation, earned today but to be paid in the future. So, once a public employee has worked even a single day, he or she has not only earned that day’s pay but also the guaranteed right to any future pay (i.e. retirement benefits) that was included as part of the employer’s promise of compensation. Therefore, public employees’ pension benefits cannot be taken away unilaterally, whether by statute, ordinance, or other action. Possible exceptions to this concept include collectively bargained benefit changes and relinquishment of benefits under the Pension Forfeiture Act.

### Fiduciary Responsibility

The ultimate responsibility for any pension plan rests with the governing body. The governing body has a fiduciary responsibility for the ongoing administration and funding of the pension plan and the prudent investment of pension trust funds. A fiduciary is defined as “a person who has a duty to transact business or handle the money, not for his (or her) own benefit but for the benefit of another. A fiduciary relationship imposes a duty to act in good faith and candor, with a special regard to the interest of the person who places this trust and confidence in the fiduciary.”

The governing body has the authority to delegate certain duties to municipal staff, committees, boards, investment managers, third party administrators, trustees, or custodians. A pension board can serve a valuable function in the ongoing administration of the pension plan. It should, however, act in an advisory capacity (except for those responsibilities specifically outlined in the Third Class City Code).

### ***Administrative and Funding Fiduciary***

The governing body has certain responsibilities under state statutes that directly impact the pension plan, and under the Internal Revenue Code. It is important for the governing body to be aware of and comply with the statutory requirements which are further detailed later in this handbook. Likewise, the governing body is responsible for maintaining the plan's qualified status under the Internal Revenue Code, so that benefits earned are not required to be included in participants' current taxable income.

The responsibility for the plan's solvency rests with the governing body as well. Benefits are granted to employees through collective bargaining or unilaterally. The benefits are then formalized in the labor contract, ordinance, or resolution and plan document if one exists. In a defined benefit pension plan, if the plan assets lose their value or do not perform to expectations, the governing body must make up any additional contributions (directly or through increased state aid). It is not only mandated by statute but fiscally responsible for a municipality to have an actuarial study performed prior to making any benefit changes. The study should provide a reasonable estimate of the financial impact on the plan.

Pension plans have expenses other than the cost of pension benefits such as legal, actuarial, or investment management fees. These expenses must be considered when determining the funding requirements of the plan. If an individual or agency offers "free" actuarial services or investment management as incentive to purchase other pension plan services from them, municipal officials should consider:

- The ultimate cost of the pension plan depends largely on the success of the investment policy.
- What is usually meant by "free" is that the fees for the services are hidden. (Actuaries and investment managers are generally highly trained specialists who expect fair compensation for their services.) Accepting a low yield or less flexible investment vehicle in exchange for "free" services may actually increase required municipal contributions.
- If the individuals providing the "free" services are not employed directly by the plan, their primary responsibility is to the entity that employs them, not the pension plan. This may affect their evaluation of the disadvantages of products and services provided by their client.
- The plan's consulting actuary is the guide to a sound, cost efficient pension plan. One of the most important services expected from the actuary is an objective, critical analysis of all aspects of the plan including the products and services provided by outside agencies. To assure quality services, the consulting actuary should be employed directly by the plan and be accountable only to pension plan officials.

### ***Investment Fiduciary***

According to Generally Accepted Accounting Principles, public employee pension trust funds are fiduciary fund types, subject to fiduciary standards. Pension plan fiduciaries must consider the legality, quality, liquidity, and return of the pension plan's investments. The legality of investments of most public employee pension plans is controlled by Chapter 73 "Municipalities Investments" of the Probate, Estates and Fiduciaries Code (Title 20 of the Consolidated Statutes of Pennsylvania). The governing statutes of most local government pension plans authorize any investment authorized by Chapter 73 for any pension or retirement fund of the municipality. Chapter 73 requires that pension plan fiduciaries select from a specified list of investments or apply the "Prudent Person Rule" in investing pension funds. In general, the Prudent Person Rule requires that a fiduciary exercise the same judgment and care that men of prudence, discretion, and intelligence exercise in the management of their own affairs. The fiduciary must consider both the probable income to be earned from an investment and the probable safety of the underlying capital.

## II. Types of Pension Plans

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There are four types of pension plans prevalent in local government. The three basic types are: defined contribution, defined benefit, and multi-employer. The fourth type, hybrid plans, blends features of defined contribution and defined benefit plans. The major distinctions between these types of plans include the risk-bearing party (employer or employee), the way in which benefits are determined (and typically paid) after the end of a participant's employment, and the relative level of portability of these benefits. They vary in many other ways, including funding mechanism and Act 205 reporting requirements, which will be addressed in later sections of this publication.

### Defined Benefit Plans

In a defined benefit plan, the employer promises a definite benefit, at a specified retirement date (based on age and/or service) usually equal to a percentage of compensation or a dollar amount per year of service, and funds the plan accordingly. The employer bears the investment risks, with investment losses increasing the employer's annual contribution requirements, and investment gains reducing (or in some cases even eliminating) the employer's required annual contribution. Benefits are usually paid monthly over a participant's life span, and may continue to a beneficiary in some cases.

Governing statutes stipulate that pension plans provided by many municipal governments for their employees must be defined benefit plans.

### Defined Contribution Plans

In a defined contribution plan, a defined amount of money is deposited into the pension fund on behalf of each eligible employee on a periodic basis (annually, quarterly, monthly, etc.). The employer's required contribution is based solely on the defined amount which is usually a flat dollar or fixed percentage of pay, without fluctuation due to investment performance. There is no guaranteed retirement benefit in a defined contribution plan. The benefit paid from the plan is determined based upon the accumulated contributions, investment earnings, and experience gains and losses credited to the individual's account, meaning the employee bears the investment risk in a defined contribution plan. The benefit is typically paid in a lump sum.

Defined contribution plans may be the primary pension plan provided for a local government's non-uniformed employees or non-city police forces consisting of less than three full-time officers. Most Defined Contribution Plans that are provided as the sole retirement plan for municipal government employees are established pursuant to the Internal Revenue Code Section 401(a). In addition, some employers who have decided to change their defined benefit plan to a defined contribution plan for new employees have chosen to "piggy-back" this type of Defined Contribution plan onto the existing defined benefit plan, retaining the same eligibility requirements and enabling a single trust to be used to administer both plans. A third type of defined contribution plan that is prevalent in local government is an IRC Section 457(b) plan. These plans, however, are not eligible for General Municipal Pension System State Aid, and are therefore typically used as a supplemental plan in which employees may elect to participate.

### Hybrid Plans

Over time, some government entities have chosen to blend elements of defined contribution and defined benefit plans into a single plan often known as a "hybrid" plan. On the surface, these plans usually resemble a defined contribution plan, with employers depositing a defined amount into the plan each year on behalf of each eligible employee. However, these plans also usually contain a guaranteed earnings level that is allocated to the employees "accounts". Since the credited earnings are guaranteed, the plan is actually a defined benefit plan. The employer bears investment risk in a hybrid plan as in a defined benefit plan. If the plan's investment returns do not meet the guaranteed rate, the employer must make up the difference which results in an increase in the employer's annual required contribution. Conversely, if earnings exceed the guaranteed rate, the employer's annual required contribution declines.

## **Multi-Employer Plans**

In a multi-employer plan, usually sponsored by a labor union, the employer makes a fixed contribution based upon the terms of a collective bargaining agreement, which may or may not relate to the nature of the benefit promise. The plan could provide a defined pension based on a percentage of compensation, or simply accumulated contributions in the accounts of the employees. Most of the plan administration is handled by the union, so there are very few responsibilities left for the municipality to take care of.

## III. Municipal Pension Plan Funding & Reporting Requirements

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### **Pennsylvania Act 205 of 1984 - Municipal Pension Plan Funding Standard and Recovery Act**

The municipal pension plan funding and reporting requirements in effect today were established through the Municipal Pension Plan Funding Standard and Recovery Act, also known as Act 205. This pension reform legislation was signed on December 18, 1984 and included reforms to the funding, reporting, and financing of municipal pensions in Pennsylvania. The major issues addressed by the legislation are:

- Standardized actuarial and financial reporting
- Determination and payment of unfunded actuarial accrued liability
- Recovery plan and additional state funding for "distressed" pension plans
- Requiring cost studies of proposed benefit changes prior to adoption
- Revision of the allocation formula for distributing state aid to pension plans (including new funding for non-uniformed plans)
- Revision of the distribution of State Foreign Fire Insurance taxes for Volunteer Firefighters Relief Associations
- Establishing minimum employer contribution requirements

Act 44 of 2009 amended certain sections of Act 205, modifying its rules for amortizations of unfunded liabilities, implementing a new recovery program, legalizing DROP benefits, and requiring specific procedures for the procurement of professional services. The funding and reporting requirements outlined herein incorporate the changes enacted by Act 44.

#### ***Reporting Requirements***

Beginning with the plan year commencing in 1985, and biennially thereafter, each municipality and authority was required by Act 205 to have an actuarial report prepared for each defined benefit pension plan it sponsored. The valuation must follow a prescribed format, and be calculated using standardized assumptions and cost methods. These biennial valuations must be prepared and signed by an Approved Actuary - "A person who has at least five years of actuarial experience with public pension plans and who is either enrolled as a member of the American Academy of Actuaries or enrolled as an actuary pursuant to the Federal Employee Retirement Income Security Act of 1974."

Actuarial valuation reports must be submitted to the Public Employee Retirement Commission (PERC) every other year (biennially) regardless of the size of the plan. Pension plans with 1,000 or more members must also submit a five-year experience investigation report every four years (every other biennial reporting cycle).

Act 205 actuarial reporting forms are prepared as of January 1 every odd-numbered year for all municipal plans - defined benefit, defined contribution, hybrid, and multi-employer. The forms must be filed with PERC no later than the last business day of March following the year of preparation. The law clearly places the responsibility for supervision and direction of the plan with the Chief Administrative Officer of the pension plan, who is also responsible for filing the document. In the event the report is not filed in a "timely fashion," all financing that the commonwealth provides to the municipality for the pension plan may be reduced and/or withheld until the report is filed. All pension plans may pay the fees associated with the preparation of the actuarial reports from the assets of the pension plan.

### **Funding Requirements**

A defined benefit plan's liabilities and resulting annual funding requirements determined through the valuation process are based upon certain facts and assumptions, including:

- Demographics of covered participants
- Benefit provisions/specifications
- Return on investments
- Salary increases
- Timing and likelihood of participant termination, death and/or disability

Generally, if there are no changes to the plan provisions, and if the assumptions used in calculating the required contributions match the actual plan experience, the annual funding requirements will remain relatively constant, as a percentage of payroll. If, however, actual experience differs from the assumptions (for example, higher/lower investment earnings are realized; higher/lower salary increases are granted; and /or plan provisions change), then the contribution requirement will change.

For defined contribution plans, the annual contribution is typically fixed by the plan provisions as a percentage of pay or a flat dollar amount. Contribution requirements are not affected by gains or losses.

There are five sources of funding that will eventually be used to pay benefits from a pension plan: (1) state aid, (2) employee contributions, (3) municipal contributions, (4) investment earnings, and (5) gifts.

### **Amortization of Unfunded Liabilities**

An unfunded liability is the amount by which the plan's liabilities exceed the assets. Effective January 1, 1985, the unfunded liability was recalculated for all municipal pension plans. The amount of the initial unfunded liability was amortized over the next 30 years or the average future service of the active participants, whichever was less. Amortization periods for increases or decreases to the initial unfunded liability resulting from benefit changes, assumption changes, or actuarial experience occurring between 1985 and 2009 were specified in Act 205. Act 44 (amending Act 205) changed those periods effective for changes recognized after 2009. The amortization periods for each type of gain or loss are outlined below.

**TABLE 1**

### **Amortization Period Applied to Change in Unfunded Liability**

<b>Change Resulting From</b>	<b>1985 - 2009</b>	<b>After 2009</b>
Actuarial Assumptions	20 Years	15 Years
Benefit Change - Actives	20 Years	10 Years
Benefit Change - Inactives	10 Years	1 Year (immediately)
State Mandated Change	n/a (based on above)	15 Years
Actuarial Experience Gain/Loss	15 Years	20 Years

Unless a municipality is moderately or severely distressed (*see Recovery Program below*), the amortization periods above are limited to the average future service of the active participants, if less.

Pension plan sponsors may make an irrevocable election to amortize the entire balance of unfunded liability for a plan over a 10 year open period, as long as the ratio of assets to actuarial accrued liabilities at the last valuation date was at least 70%. This option may be desirable, for example, for plans with no active employees or if all active employees are eligible for retirement, in which case the entire unfunded liability would otherwise be required to be paid in one payment (amortized over 1 year because average future service is 0).

**Recovery Program**

The recovery program originally established by Act 205 was intended to provide funding relief measures, most of which expired over time. In 2009, Act 44 was passed, reestablishing some of the prior remedies under new distress criteria and providing voluntary or mandatory remedies for use by municipal plan sponsors. The mandatory or voluntary nature of the remedies is determined based on the municipality’s pension systems’ distress level (the ratio of total Actuarial Value of Assets (AVA) for all plans sponsored to total Actuarial Accrued Liabilities (AAL) of all plans). New distress levels were determined at January 1, 2009, and are updated based on the results of the subsequent biennial valuations filed with PERC.

**TABLE 2**

**Distress Levels**

<b>Distress Level</b>	<b>Aggregate Funding Ratio (AVA / AAL)</b>
0 (None)	90% or greater
1 (Minimal)	70%-89%
2 (Moderate)	50% - 69%
3 (Severe)	Less than 50%

**Remedies Available**

The remedies available at each distress level (as of the date of publication) appear below. In general, as municipalities change from a higher distress level to a lower level, they retain eligibility for the remedies that were available at the higher distress level. As municipalities change from a lower distress level to a higher level, they become eligible for additional remedies available at the higher level. The initial elections were effective January 1, 2011.

**TABLE 3**

**Remedies for Each Distress Level**

<b>Distress Level</b>	<b>Mandatory</b>	<b>Voluntary</b>
0	None	None
1	None	<ul style="list-style-type: none"> <li>• Aggregate pension funds for administration and investment</li> <li>• Establish total member contribution</li> <li>• Deviate from municipal contribution limitations</li> <li>• Reduce MMO by 25% of amortization payment for 2 years</li> </ul>
2	<ul style="list-style-type: none"> <li>• Aggregate pension funds for administration and investment</li> <li>• Submit a plan for administrative improvement</li> </ul>	<ul style="list-style-type: none"> <li>• Establish total member contribution</li> <li>• Deviate from municipal contribution limitations</li> <li>• Utilize special taxing authority under Act 205</li> <li>• Establish revised benefit plan for new hires</li> <li>• Reduce MMO by 25% of amortization payment for 4 years</li> </ul>
3	<ul style="list-style-type: none"> <li>• Aggregate pension funds for administration and investment</li> <li>• Submit a plan for administrative improvement</li> <li>• Establish revised benefit plan for new hires</li> </ul>	<ul style="list-style-type: none"> <li>• Establish total member contribution</li> <li>• Deviate from municipal contribution limitations</li> <li>• Utilize special taxing authority under Act 205</li> <li>• Reduce MMO by 25% of amortization payment for 6 years</li> </ul>

## **Benefit Changes**

Prior to the adoption of any benefit plan modification by the governing body of the municipality, Section 305 of Act 205 requires that the Chief Administrative Officer of the pension plan provide the governing body with an actuarial study of the financial impact of the change.

## **State Aid**

The Commonwealth of Pennsylvania provides for an annual allocation to municipal pension plans from a special fund dedicated exclusively to fund retirement plans. The source of the fund is a 2% tax paid on foreign casualty insurance premiums.

The amount each municipality receives primarily depends on such factors as the financial need of its plans and the number of full-time employees participating in a plan. Each municipality receives its allocation (whether by check or direct deposit) by October 1 each year. The governing body must allocate the state aid among its plans and make the deposits to the respective funds within 30 days. If additional funds are needed to meet the minimum obligation, the municipality must contribute the balance from their general fund by December 31.

The governing body of the municipality determines into which of the respective pension plans the money should be deposited based upon their funding requirements. The funds cannot be used for anything other than pension plan costs. The Department of the Auditor General periodically audits each of the retirement plans of the municipality to ensure the proper allocation and use of State Aid funds.

### ***Eligibility***

There are some plans or municipalities that are not eligible for state aid. Generally, the following types of plans are not eligible for state aid.

- Section 457 Plans (deferred compensation plans)
- Plans which have not been funded by the governing body for at least 3 years
- Municipal authority plans
- County plans
- Individual retirement accounts (IRA)
- Illegal plans (plan provisions not in compliance with appropriate state laws)

The state aid for an entire municipality could be withheld, reduced or eliminated for other reasons. Some of those reasons include:

- Late filing of Act 205 Reporting Form or AG-385 Form
- No filing of Act 205 Reporting Form or AG-385 Form
- Inaccurately completed Act 205 Reporting Form or AG-385 Form
- Refund owed to the state not paid
- Failure to pay Minimum Municipal Obligation
- Outstanding Order to Show Cause

### ***Amount of State Aid***

The amount of State Aid available to most municipalities is determined by comparing the financial need of all plans sponsored by the municipality to the unit value calculation of all qualified plan participants. The Financial Need calculation and the unit value calculation are determined by the Department of the Auditor General for each municipality that sponsors a retirement plan. The municipality will receive the lesser of those amounts each year.

**Financial Need Calculation**

The financial need calculation is based upon the total payroll reported on the annual AG-385 Form filed with the Department of the Auditor General (AG) and the cost components contained in the most recent biennial actuarial report filed with the Public Employee Retirement Commission (PERC).

For each defined benefit retirement plan, PERC certifies to the AG the Normal Cost Percentage (NCP) and either the amortization payment or the funding adjustment credit. The NCP is the normal cost (NC) plus the average administration expense (AAE) minus the member contributions (MC), divided by the total annual payroll (TAP). These figures can be found on the Act 205 Form.

$$NC + AAE - MC / TAP = NCP$$

The normal cost percentage (NCP) is multiplied by the payroll certified on the AG-385 Form. *(Note that this normal cost percentage is different from the Normal Cost Percent used on your Minimum Municipal Obligation)*

$$NCP \times \text{Payroll} = \text{Normal Cost}$$

The Department of the Auditor General either adds the amortization contribution to the normal cost, or subtracts the funding adjustment from the normal cost to determine the need for each plan.

The defined contribution Normal Cost Percentage is determined by dividing the employer contribution by the payroll on the Act 205 Form. The Normal Cost Percentage is then multiplied by the AG-385 payroll to determine the financial need of the plan.

The financial need for each of the plans sponsored by a municipality is added together to determine the total municipal financial need.

**Unit Value Calculation**

The unit value calculation is based upon the number of units for the municipality multiplied by the State Aid Unit Value, as determined by the Department of the Auditor General.

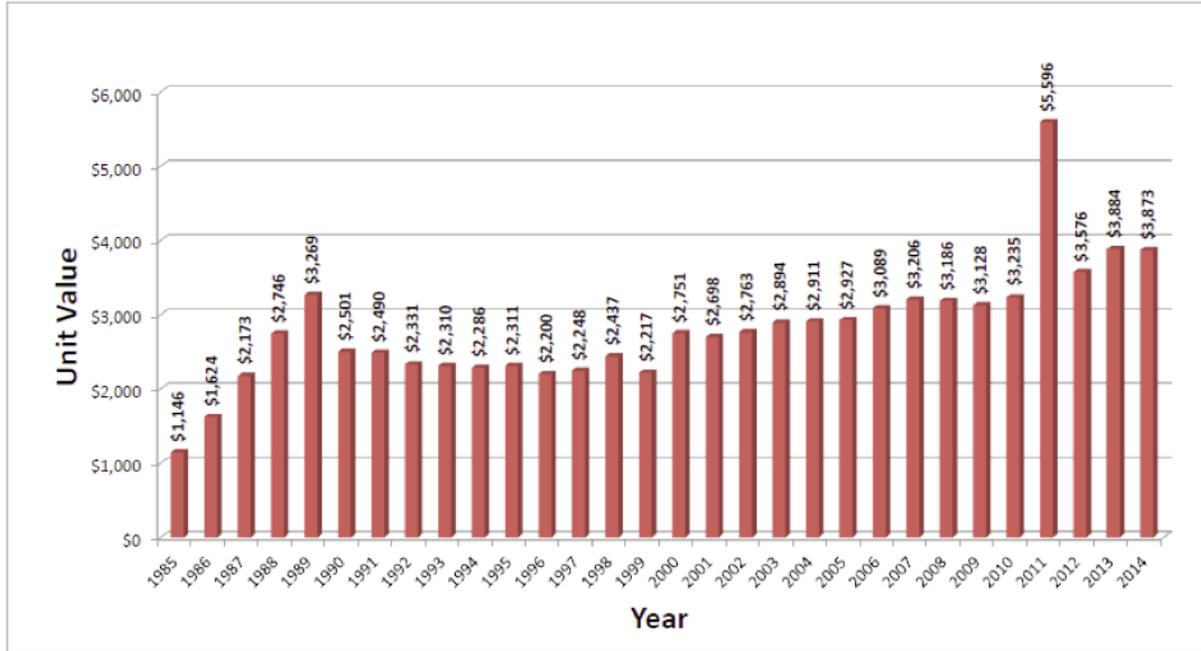
The number of units for the municipality is determined by adding the applicable number of units which are attributable to each eligible employee. An eligible employee is an active member of an eligible pension plan, employed on a full-time basis (at least 35 hours per week), for a minimum of six consecutive months in the prior year. The applicable number of units for each eligible employee is as follows:

Police Officer:	2 units	} If in a separate police/fire plan; 1 unit if participating in a plan with non-uniformed/general employees.
Paid Firefighter:	2 units	
All other employees:	1 unit	

The State Aid Unit Value is determined on an annual basis by the Department of the Auditor General based upon the total revenues collected, the total number of units certified by all eligible municipalities, and certain adjustments required by law. The chart on the following page shows the State Aid Unit Value amounts through 2014.

TABLE 4

History of State Aid Unit Value



Year	Unit Value	Percent Change									
1985	\$ 1,145.75		1992	\$ 2,331.48	-6.4%	2000	\$ 2,751.05	24.1%	2008	\$ 3,186.33	-0.6%
1986	\$ 1,624.04	41.7%	1993	\$ 2,309.91	-0.9%	2001	\$ 2,698.21	-1.9%	2009	\$ 3,128.01	-1.8%
1987	\$ 2,173.36	33.8%	1994	\$ 2,285.78	-1.0%	2002	\$ 2,762.97	2.4%	2010	\$ 3,234.84	3.4%
1988	\$ 2,746.48	26.4%	1995	\$ 2,311.25	1.1%	2003	\$ 2,894.40	4.8%	2011	\$ 5,596.43	73.0%
1989	\$ 3,268.71	19.0%	1996	\$ 2,199.69	-4.8%	2004	\$ 2,911.36	0.6%	2012	\$ 3,576.11	-36.1%
1990	\$ 2,500.58	-23.5%	1997	\$ 2,247.51	2.2%	2005	\$ 2,926.77	0.5%	2013	\$ 3,884.36	8.6%
1991	\$ 2,489.57	-0.4%	1998	\$ 2,437.46	8.5%	2006	\$ 3,088.52	5.5%	2014	\$ 3,872.95	-0.3%
			1999	\$ 2,216.66	-9.1%	2007	\$ 3,206.39	3.8%			

**Budgeting / Minimum Municipal Obligation (MMO) Calculation**

Annually, Act 205 requires the Chief Administrative Officer of the pension plan to determine the total financial requirement and the required municipal contribution, known as the Minimum Municipal Obligation (MMO), for the next year. For defined benefit plans, the MMO must be based upon the most recent actuarial report filed with PERC. For defined contribution plans, the MMO must be based on the anticipated contribution rate defined in the plan document or bargaining agreement/contract.

MMO calculations must be prepared for the upcoming calendar year, certified by the Chief Administrative Officer, and submitted to the municipality's governing body by the last business day of September. Note that if the plans assets exceed the present value of future benefits based on the last valuation prepared for filing with the Public Employee Retirement Commission, no MMO is required.

The governing body, when preparing each year's budget, must include the MMO for all plans it sponsors as an expense. In addition, the estimated amount of general municipal pension system state aid (if eligible) should be budgeted as a receipt. If state aid is overestimated, the municipality must make up the shortfall by year end, even though the shortfall amount was not included in the original budget. Just the opposite will occur if the state aid is underestimated. In that case, the municipal share is simply reduced or eliminated.

An accurate estimate of state aid will enable municipalities to include an appropriate amount in the budget for local contributions and avoid surprises the following October when the state aid is received. This is especially important if the employee contribution rate depends on whether a local contribution will be needed.

### ***Defined Benefit MMO***

The MMO calculation for a defined benefit pension plan typically contains four components. The first three – normal cost, anticipated administrative expenses, and the amortization payment or funding adjustment credit – comprise the annual funding requirement of the plan. The fourth component, the anticipated employee contributions, is deducted from the annual funding requirement to obtain the minimum municipal obligation. These components are described below.

**Normal Cost** is the annual cost component of funding a pension plan. The actuarial report contains the amount expressed as a percentage of pay.

**Administrative Expense** is the anticipated amount to be paid from the plan assets, as permitted by Act 205, for actuarial and certain other administrative expenses. If expenses are paid from plan assets, an amount representing an estimate of the expenses for the upcoming year should be included in the MMO. The last actuarial report may contain an estimate of the average administrative expense expressed as a percentage of pay.

**Amortization Payment** appears in the actuarial valuation report and represents the annual amount that must be deposited to pay off the plan's existing Unfunded Actuarial Accrued Liability, if any. Actuarial gains and losses are amortized, as separate amortization bases, over various periods at each valuation date. The Amortization payment amount included in the MMO is the sum of each individual base's annual payment amount. If the actuarial report indicates that the plan has a Funding Adjustment, there will be no Amortization Payment.

**Funding Adjustment** appears in the most recent actuarial valuation report and reflects 10 percent of the excess of the Actuarial Value of Assets over the Actuarial Accrued Liability, if any. If the actuarial report indicates that the plan has an Amortization Payment, there will be no Funding adjustment.

**Employee Contributions** are estimated by multiplying the estimated payroll for the current year by the anticipated contribution rate for the following year.

The estimated payroll used to calculate the various components of the following year's MMO calculation is the estimated pay for each member of the plan during the current year. This figure should be the best estimate of pay for the current year determined by adding current year W-2 pay up to the date of calculation, to the projected salary or base wages using the payroll rates in effect from the date of calculation to year end. Payroll should only be included for plan members that are active eligible employees at the time the MMO is prepared. Pay for DROP participants should be excluded.

### ***Defined Contribution MMO***

Though preparing an MMO for a defined contribution plan is required, the amount calculated may not be equal to the actual employer contribution obligation. This is unlike a defined benefit plan in which the MMO is exactly equal to the employer obligation. In a defined contribution plan, the MMO should be viewed as more of a "budget estimate." The actual contribution is determined by the employer contribution rate, actual plan year, payroll, and actual eligible participants. The payroll that should be used for the MMO calculation should be the projected payroll for the budget year (upcoming year) including projected increases in salaries and membership.

### ***Amending an MMO***

An MMO may, but is not required to, be amended after September 30 to increase the estimated payroll, or if a more current actuarial valuation report is completed for filing with PERC. However, it is important that the employee contribution rate of the final MMO matches the actual rate for the upcoming year. The final MMO must be adopted by the time the final municipal budget is adopted.

### ***Paying the MMO***

State aid must be deposited to the individual plan(s) within 30 days of receipt (approximately October 30). The balance of the MMO or employer contribution must be deposited to the appropriate plan by December 31.

If state aid is deposited after the 30-day grace period, interest must also be deposited based on the actual rate that would have been earned by the plan. Any unpaid portion of the MMO after December 31 must be paid as soon as possible along with an interest penalty. The interest penalty is calculated based on the greater of the interest rate assumption used in the actuarial report or the six-month Treasury Bill rate on the last business day of the plan year. The interest is calculated from the beginning of the plan year in which it was due through the month of payment, compounded monthly.

#### **Questions:**

**1. Can we pay our plan's MMO at the beginning of the year so that we can earn as much interest as possible?**

*Yes! Depositing all or part of the contribution at the beginning of the year for that year will help increase plan earnings for the year. Then, when the state aid is allocated around October 1, you may simply reimburse the municipality's account for the amounts already deposited.*

**2. We deposit the employer contribution for our defined contribution plan on each payday with the employee contribution. Can we use state aid for this?**

*Yes. When the state aid check comes, you can reimburse the municipality for contributions made year to date (as long as they were for the current plan year) and reserve an amount needed to pay contributions for the balance of the year in an interest bearing account.*

**3. What should we do if we get more state aid than we need to pay our MMOs?**

*If you have funded the full amount of the MMO for your defined benefit plans and the required employer contribution for your defined contribution plans, you may use the rest in any of the following ways:*

- a. Extra contribution to a defined benefit plan*
- b. Extra contribution to more than one defined benefit plan*
- c. Reimburse the municipality for any plan administrative expenses incurred during the year and paid by the general fund*

*If none of these apply (because you only have a defined contribution plan and have no further administrative expenses to reimburse) you should contact the Department of the Auditor General to see if the excess should be returned.*

Sample Defined Benefit MMO for 20\_\_\_\_

\_\_\_\_\_ Pension Plan

**FINANCIAL REQUIREMENT AND MINIMUM MUNICIPAL OBLIGATION**

**A. Normal Cost**

- 1. Normal Cost as a Percent of Payroll. .... \_\_\_\_\_%
- 2. Estimated 201X-1 Payroll for Active Participants ..... \$ \_\_\_\_\_
- 3. Normal Cost (A1 x A2) ..... \$ \_\_\_\_\_

**B. Financial Requirement**

- 1. Normal Cost (A3) ..... \$ \_\_\_\_\_
- 2. Anticipated Administrative Expense ..... \_\_\_\_\_
- 3. Amortization Payment, if any ..... \_\_\_\_\_
- 4. Financial Requirement (B1 + B2 + B3) ..... \$ \_\_\_\_\_

**C. Minimum Municipal Obligation**

- 1. Financial Requirement (B4) ..... \$ \_\_\_\_\_
- 2. Anticipated Employee Contributions ..... \_\_\_\_\_  
( \_\_\_\_\_% of Estimated Payroll)
- 3. Funding Adjustment, if any ..... \_\_\_\_\_
- 4. Minimum Municipal Obligation (C1 - C2 - C3) ..... \$ \_\_\_\_\_

**NOTES:**

- 1. 20\_\_\_\_ General Municipal Pension System State Aid may be used to fund part or all of the municipal obligation and must be deposited within 30 days of receipt. Any remaining balance must be paid from municipal funds.
- 2. Deposit into the Plan's assets must be made by December 31, 20\_\_\_\_ to avoid an interest penalty.
- 3. Any delinquent Minimum Municipal Obligation from prior years must be included in the 20\_\_\_\_ budget along with an interest penalty.

*I hereby certify that the above calculations, to the best of my knowledge, are true, accurate, and conform with the provisions of Chapter 3 of Act 205 on 1984.*

Certified By:

\_\_\_\_\_  
Chief Administrative Officer  
Prepared using the January 1, 20\_\_\_\_ Valuation

\_\_\_\_\_  
Date

## IV. Primary Governing Statutes

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Whether or if any statutory provisions govern the creation and maintenance of an employee pension plans depends on the type of municipality and the employee class. Pension plans sponsored by Pennsylvania's largest cities — Philadelphia, Pittsburgh, and Scranton — each have their own governing statute. County pension plans are generally covered by a separate County pension code.

Other statutes apply to pension plans (or specific benefits of plans) sponsored by local government entities other than counties or first or second class cities. While the benefit structure of most police pension plans (and city firefighter and officer & employee plans) are almost always controlled by statute, other employee plans are largely unregulated and are governed solely at the municipal level. The following governing statutes are described in depth in the upcoming sections.

**Act 600** — applies to police pension plans for full-time police officers in a borough, town or township, and those regional police departments established after May 10, 1996. Municipalities with one or two full-time police officers may comply with Act 600; however, municipalities with three or more full-time police officers and regional police departments must comply with Act 600. Act 600 includes mandatory and optional provisions for benefits.

**Third Class City Code** — includes sections pertaining to the establishment of retirement plans for employees of Third Class Cities. These cities must establish a pension fund for police officers and for paid firefighters. The cities may establish a pension fund for other city employees using the regular city plan requirements or the optional plan requirements.

**Borough Code** — authorizes retirement benefits for non-uniformed borough employees and outlines benefits that must be provided if a pension plan is offered for borough police officers where less than three full-time officers are employed (if the Borough hasn't opted to comply with Act 600) .

**First Class Township Code** — Section 1409 requires first class townships to establish a police pension fund for officers of their force. The code serves as the governing statute for the pension plan, as long as the township's force consists of less than three full-time officers.

**Second Class Township Code** — Within Article XIX, the board of supervisors is authorized to establish a police pension fund for the Township's officers, with the Code being the plan's governing statute in the case that less than three officers are employed on a full-time basis. Certain benefits are cited as permitted to be paid from the plan if a plan is offered.

**Pennsylvania Municipal Retirement Law** — Provides that any municipal pension plan, whether a borough, township, or city; a police, fire, or non-uniformed plan, can establish a plan or transfer a plan to PMRS. It establishes an entire administrative and investment program including a choice of various levels of benefit provisions. This law is the governing statute for all PMRS plans (superseding any statutes that would otherwise apply, such as Act 600).

**Act 44 of 2009** — included a section authorizing Deferred Retirement Option Plans (DROPs) statewide. DROPs established on or after September 18, 2009 must comply with the specifications contained in Act 44.

## V. Act 600 – The Municipal Police Pension Law

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### Applicability

Act 600 applies to police pension plans for full-time police officers in a borough, town or township, and those regional police departments established after May 10, 1996. Municipalities with one or two full-time police officers may comply with Act 600; however, municipalities with three or more full-time police officers and regional police departments must comply with Act 600, unless they have elected to operate under Act 15 of 1979, the Pennsylvania Municipal Retirement Law (see section on Pennsylvania Municipal Retirement Law below). Act 600 includes mandatory and optional provisions for benefits.

### Pension Plan Provisions

Act 600 mandates that certain benefits *must* be provided under a pension plan established in accordance with this statute. It also provides optional provisions that *may* be included in a plan established under the statute.

#### *Mandatory Provisions*

##### **Age and Service Requirements for Retirement**

A participant must attain age 55 and complete 25 years of service in the same municipality to be eligible for a normal retirement benefit.

##### **Monthly Pension Benefit**

The monthly pension benefit is fifty percent of the average monthly salary. The average monthly salary may be based on a period of not less than 36 months and not more than 60 months immediately prior to retirement.

##### **Social Security Offset**

For those municipalities where police officers are covered by the Federal Social Security Act, the monthly pension benefit, upon attainment of normal social security retirement age, may be offset by up to 75 percent of the primary social security benefit as calculated using wages earned by the participant while employed as a police officer by the municipality.

##### **Employee Contributions**

Plans provided for police officers that are not covered by social security have a mandatory employee contribution rate of between 5 and 8 percent of the officer's total monthly compensation. For plans whose members are covered by social security, the mandatory rate is 5 percent, if there is no social security offset.

If the retirement benefit is offset by social security, the maximum mandatory employee contribution will be calculated as follows:

$$5\% - (3\% \times \text{social security offset percentage})$$

For example, if your plan includes a 75 percent offset, the mandatory employee contribution rate is:

$$5\% - (3\% \times 75\%) = 5\% - 2.25\% = 2.75\%.$$

##### **Return of Employee Contributions**

Employees who become ineligible to receive a pension benefit for any reason must have their total contributions plus interest refunded by the plan. If the reason for payment is due to the death of the employee, then the refund is paid to the beneficiary.

### **Intervening Military Service**

A regularly appointed member of the police force who has been employed as such for at least six months, and who enters active military service for the United States, must receive retirement credit for the period of active military service. To be eligible, the person must return to employment within six months of separation from such military service and be ineligible to receive military retirement pay as a result of that service. (Federal military service credits may also be applicable.)

### **In-Service Disability**

The plan must provide a disability benefit if a police officer incurs a total and permanent disability (unable to perform the usual and customary duties of a police officer) as a direct result of, and in the line of duty of, employment as a police officer. The minimum monthly benefit is 50% of the officer's salary at the time of disablement, offset by social security disability benefits received for the same injury or illness.

### **Surviving Spouse Benefit**

A benefit designed to pay the spouse of a deceased police officer who was retired or eligible to retire at the time of death. The benefit is equal to 50 percent of the normal pension benefit to which the participant was entitled or was actually receiving, and is payable to the surviving spouse for his/her lifetime. Upon the death of the spouse, or if there is no spouse, the participant's dependent children will receive the benefit until age 18, or age 23 if attending college.

### **Optional Provisions**

#### **Reduced Retirement Age**

A reduction in the retirement age from 55 to as low as 50 may be provided if an actuarial cost study indicates that it is feasible. The completion of at least 25 years of service is still required.

#### **Reduce Social Security Offset**

The social security offset to pension benefits may be reduced or eliminated. Such a reduction would change the mandatory maximum employee contribution rate (*see Employee Contributions*).

#### **Vesting Provisions**

A vesting provision may be added allowing an employee who terminates with 12 or more years of service to receive a partial pension benefit. The benefit would commence when the employee would have become eligible for normal retirement.

#### **Elimination/Reduction of Employee Contributions**

Employee contributions may be reduced or eliminated on an annual basis by ordinance or resolution.

#### **Length of Service Increments**

Participants can earn additional retirement benefits by completing years of service in excess of 25 years. The maximum additional monthly benefit that can be earned per year is \$100 and the total additional benefit may not exceed \$500 per month.

#### **Cost-of-Living Adjustments (COLA)**

The purpose of adding a COLA is to offset the loss of "purchasing power" to the retiree due to inflation. This provision provides for an annual increase of retiree benefit payments based on an external index (i.e., Consumer Price Index). The total benefit plus increases may not exceed 75 percent of the average salary used for computing retirement benefit. Further, the total increases may not exceed 30 percent of the original benefit. No COLA shall be granted which would impair the actuarial soundness of the fund. For plans whose assets exceed the Present Value of Future Benefits, (i.e., fully-funded) and whose retirees have received benefits for 20 or more years, the COLA increase may exceed the limits listed above.

#### **In-Service Disability**

The amount of the disability benefit may be increased to an amount greater than the mandatory minimum benefit.

### Surviving Spouse Benefit

The amount of the surviving spouse benefit may be increased to an amount greater than the mandatory 50% of the participant's benefit.

### Non-Intervening Military Service

A participant may purchase retirement credit for up to five years of active military service with the United States which occurred before employment with the municipality began, if the participant is not eligible to receive military retirement pay for that service. The participant must pay an amount equal to the average normal cost for similar municipalities (but not more than 10 percent), times the participant's average annual compensation during the first three years of employment as a police officer, plus interest at the rate of 4.75 percent compounded annually, from the participant's date of hire to the date of payment.

### Early Retirement Provision

This provision allows members with 20 or more years of service the option of retiring prior to normal retirement. The benefit is the actuarially reduced accrued benefit. The actuarial reduction is based on the interest rate and mortality table used in the latest actuarial report submitted to the state.

Example: A police officer is hired at age 30 with a normal retirement age of 55. The officer is currently 50 and with an average monthly salary of \$4,000. Using the assumptions from the latest actuarial report submitted to the state, a reduction factor of 65.2 percent is obtained. The benefit would be calculated in the following manner.

- **Normal Retirement Benefit**

$$\begin{aligned} & \text{Average Monthly Salary} \times 50\% \\ & \$4,000 \times 50\% \\ & = \$2,000 \end{aligned}$$

- **Accrued Benefit payable at Normal Retirement Date (NRD)**

$$\begin{aligned} & (\text{Actual Yrs of Service} \div \text{Yrs from Hire Date to NRD}) \times \text{Monthly Normal Retirement Benefit} \\ & (20 \div 25) \times \$2,000 \\ & = \$1,600 \end{aligned}$$

- **Early Retirement Benefit (payable immediately)**

$$\begin{aligned} & \text{Accrued Benefit} \times \text{Actuarial Equivalent} \\ & \$1,600 \times 65.2\% \\ & = \$1,043.20 \end{aligned}$$

## **Regional Police Departments and Purchase of Service Agreements**

### ***Regional Police Departments***

Act 33 of 1996 amended Act 600 to mandate that all regional police pension plans created after May 9, 1996, must comply with the provisions of Act 600. Plans established prior to that date may continue to provide benefits previously granted, but any subsequent amendments must comply with the provisions of Act 600. It further directed that prior to the establishment of a new regional pension plan, the specific benefit structure must be determined and an actuarial valuation report must be completed. The pension plan must be adopted by ordinance by each of the participating municipalities with a consistent structure. A participant of the regional police pension plan is to be credited with all of his or her time spent in the prior plan.

### ***Purchase of Service Agreements***

*What happens when a municipality disbands their police department and purchases police services from another municipality that hires their officers?* Prior to Act 33, there were no specific statutes that provided for police officers to receive credit for the previous time worked. Now, unless the municipality is a city, an officers' service credit and appropriate assets may be transferred from the purchaser's pension plan. Should the purchasing municipality decide to terminate the agreement, they may rehire the police officer within six months and transfer the appropriate assets from the pension plan of the municipality that provided the police service.

### ***Considerations***

Many questions or issues arising from establishing, joining, dissolving, or withdrawing from a regional pension plan and/or entering or exiting a purchase of service agreement may not be addressed by Act 600. Obtaining legal guidance before proceeding to enter into or withdraw from these agreements is advisable.

## VI. Third Class City Code

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### **Applicability**

The Third Class City Code includes sections pertaining to the establishment of retirement plans for employees of Third Class Cities. These cities must establish a pension fund for police officers and for paid firefighters and may establish a pension fund for other city employees using the regular city plan requirements or the optional plan requirements. The following is an overview of the pension sections of the Third Class City Code. However, due to vagueness in the original statute, subsequent amendments, and various lawsuits which have been decided, certain provisions have been interpreted differently from one city to another. The City should seek the advice of their solicitor for interpretation of the individual provisions applicable to their plan.

### **Police Pension Fund**

#### ***Mandatory Provisions***

##### **Age and Service Requirements for Retirement**

The city shall establish a minimum service requirement of no less than 20 years of service as a police officer in the same city to be eligible for a normal retirement benefit. If a minimum age is prescribed, a minimum age of 50 may be established.

##### **Monthly Pension Benefit**

The monthly pension benefit is fifty percent of the average monthly salary. The average monthly salary is the greater of the highest average monthly salary during any five years of service or the rate of monthly pay at the date of termination of employment.

##### **Employee Contributions**

The mandatory employee contribution rate will be up to 5 percent of the officer's compensation, plus \$1 per month to provide for the service increment benefit.

##### **Return of Employee Contributions**

Employees who become ineligible to receive a pension benefit for any reason must have their total contributions, without interest, refunded by the plan. If the reason for payment is due to the death of the employee, then the refund is paid to the beneficiary.

##### **Length of Service Increment**

Additional retirement benefits accrue to attainment of age 65 to participants whose length of service exceeds the minimum required for retirement. The amount of additional benefit is 1/40 times the monthly pension benefit for each year over the minimum; it may not exceed \$100 per month.

##### **Surviving Spouse Benefit**

A benefit is paid to the surviving spouse or dependent children of a deceased police officer who was retired or killed in service. The benefit is equal to 50 percent of the normal pension benefit to which the participant was entitled, without reduction for early commencement. The benefit continues until the later of the death of the spouse or attainment of age 18 of the participant's children.

##### **In-Service Disability**

The plan provides for a disability benefit if a police officer incurs a total and permanent disability as a direct result of, and in the line of duty of, employment as a police officer. The benefit will be the normal monthly pension benefit.

## ***Elective Provisions***

### **Vesting Provisions**

Vesting provisions may be included to allow a terminated participant with at least 12 years of service to leave employment and receive a partial pension benefit. The benefit will commence when a participant would have become eligible for normal retirement.

### **Non-Service Disability**

A disability benefit may be provided for a police officer who incurs a total and permanent disability not as a direct result of, and in the line of duty of, employment as a police officer. If the participant has fewer than ten years of service, the benefit will be 25 percent of the monthly pension benefit; and if more than ten years of service, the benefit will be 50 percent of the monthly pension benefit.

### **Cost-of-Living Adjustments**

The plan may provide for cost-of-living adjustments to the pension benefit, but they may not permit a retiree to receive a benefit that exceeds 50 percent of the salary of a patrolman of the highest pay grade. Increases must be on a uniform scale.

### **Non-Intervening Military Service**

This provision provides that a participant may purchase retirement credit for up to five years of active military service with the United States, which occurred before employment with the city began, if the participant is not eligible to receive military retirement pay for that service. The participant must pay the employee contributions that would have been paid during the service, plus the equivalent of the contributions of the city as a result of that service.

### **Surviving Spouse Benefits**

The plan may increase the killed-in-service or retiree death benefit for surviving spouses to 100 percent of the normal retirement benefit. Also, a benefit may be provided for spouses of participants whose death did not occur in the line of duty. For deaths before ten years of service, the benefit may be 25 percent of compensation and after ten years of service may be 50 percent of compensation.

### **Length of Service Increment**

The plan may increase the maximum service increment benefit beyond \$100 per month, but not to exceed \$500 per month, provided that the member's monthly service increment contribution is also increased, from \$1 to up to \$5 per month.

## **Firefighters Pension Fund**

### ***Mandatory Provisions***

#### **Age and Service Requirements for Retirement**

The city shall establish a minimum service requirement of no less than 20 years of service as a firefighter in the same city to be eligible for a normal retirement benefit. If a minimum age is prescribed, a minimum age of 50 may be established.

#### **Monthly Pension Benefit**

The benefit is 50 percent of the average monthly salary. Average monthly salary is the greater of the highest average monthly salary during any five years of service or the rate of monthly pay at the date of termination of employment.

#### **Employee Contributions**

The mandatory employee contribution rate will be up to 5 percent of the firefighter's compensation, plus up to \$1 per month to provide for the service increment benefit.

#### **Return of Employee Contributions**

Employees who become ineligible to receive a pension benefit for any reason must have their total contributions, without interest, refunded by the plan. If the reason for payment is due to the death of the employee, then the refund is paid to the beneficiary.

### **Length of Service Increment**

Additional retirement benefits accrue to participants to attainment of age 65 whose length of service exceeds the minimum required for retirement. The amount of additional benefit is 1/40 times the monthly pension benefit for each year over the minimum; it may not exceed \$100 per month.

### **Surviving Spouse Benefit**

A benefit is paid to the surviving spouse or dependent children of a deceased firefighter who was retired or killed in service. The amount of the benefit is the amount the member was receiving or would have been receiving if he was retired. The benefit continues until the death of the spouse. In the case of a firefighter killed in service, benefits could be payable to dependent children until age 18.

### **In-Service Disability**

The plan provides for a disability benefit if a firefighter incurs a total and permanent disability as a direct result of, and in the line of duty of, employment as a firefighter. The amount of benefit and the date of commencement will be determined under the terms of the plan and will not take into consideration any benefits provided under applicable workers' compensation laws.

### ***Elective Provisions***

#### **Vesting Provisions**

Vesting provisions may be included to allow a terminated participant with at least 12 years of service to leave employment and receive a partial pension benefit. The benefit will commence when a participant would otherwise have become eligible for normal retirement.

#### **Cost-of-Living Adjustments**

The plan may provide for cost-of-living adjustments to the pension benefit, but may not permit the benefit to exceed 50 percent of the then current rate of pay to active firefighters of the highest pay grade.

#### **Non-Intervening Military Service**

This provision provides that a participant may purchase retirement credit for up to five years of active military service with the United States, which occurred before employment with the city began, if the participant is not eligible to receive military retirement pay for that service. The participant must pay the employee contributions that would have been paid during that service, plus the equivalent of the contributions of the city for that service, and interest on the city contribution amount.

#### **Length of Service Increment**

The plan may increase the maximum service increment benefit beyond \$100 per month, but not to exceed \$500 per month, provided that the member's monthly service increment contribution is also increased, from \$1 to up to \$5 per month.

## **Officers and Employees Pension Fund**

Though cities are not required to provide a pension plan for non-uniformed employees, if they do, there are two frameworks provided by the Third Class City Code that outline mandatory and elective provisions to be included in these plans. This section summarizes the mandatory and elective provisions of the Officers and Employees Pension Fund. The section to follow summarizes the mandatory and elective provisions of the Optional Officers and Employees Pension Fund.

### ***Mandatory Provisions***

#### **Age and Service Requirements for Retirement**

A participant must complete at least 20 years of service in the employment of the same city and have attained age 60 to be eligible for a normal retirement benefit.

### **Monthly Pension Benefit**

The benefit is 50 percent of the average monthly salary. Average monthly salary is the greater of the average monthly salary during the last or any five years of service. The monthly benefit will be reduced by 40 percent of the participant's primary social security insurance amount (if covered) at the time that the participant becomes eligible to receive the social security primary insurance benefit.

### **Employee Contributions**

The mandatory employee contribution rate will be 3.5 percent of the monthly compensation on which social security allowances are payable and 5 percent of any monthly compensation in excess of that amount. (However, should the officers and employees not be covered by social security, then the contribution rate will be 2 percent.)

### **Return of Employee Contributions**

Employees who become ineligible to receive a pension benefit for any reason must have their total contributions, without interest, refunded by the plan. If the reason for payment is due to the death of the employee, then the refund is paid to the beneficiary.

### **Early Termination Provisions**

A participant who has completed at least 20 years of service but has not attained age 60 shall be entitled to a deferred pension provided the participant continues paying monthly employee contributions equal to the last amount due while in active employment. Payments must continue until employee reaches the age of 60.

### **Disability**

The plan provides for a disability benefit if an employee incurs a total and permanent disability after completing at least ten years of service and before attaining age 60. The benefit is calculated in the same way as the normal retirement benefit but without offset for social security benefits.

### ***Elective Provisions***

#### **Surviving Spouse Benefit**

A benefit may be provided to the surviving spouse of a deceased participant who has retired or was killed in service. The benefit is equal to 50 percent of the pension benefit to which the participant was entitled as of the date of death. City Council may require additional contributions by employees of up to 1 percent of compensation, if deemed necessary, to fund this benefit.

#### **Elimination of Social Security Reduction**

The pension board may permit a participant to elect to receive a monthly pension benefit without any reduction for the payment of social security benefits provided that the participant pays the fund an amount equal to the difference between what was actually contributed to date and the amount which would have been contributed if the contribution rate had always been 5 percent of pay. Those participants must continue to make contributions of 5 percent after such election.

#### **Vesting Provisions**

Vesting provisions may be included to allow a terminated participant with at least 12 years of service to leave employment and receive a partial pension benefit. The benefit will commence when a participant would otherwise have become eligible for normal retirement.

## Optional Plan for Officers and Employees

### *Mandatory Provisions*

#### **Age and Service Requirements for Retirement**

A participant must complete at least 20 years of service in the employment of the same city and have attained age 60 to be eligible for a normal retirement benefit.

#### **Monthly Pension Benefit**

The benefit is 50 percent of the average monthly salary. Average monthly salary is the greater of the average monthly salary during any five years of service or the rate of monthly pay at retirement. The monthly benefit will be reduced by 40 percent of the participant's primary social security insurance amount (if covered) at the time that the participant becomes eligible to receive the social security primary insurance benefit.

#### **Employee Contributions**

The mandatory employee contribution rate will be 3.5 percent of the monthly compensation on which social security allowances are payable and 5 percent of any monthly compensation in excess of that amount. (However, should the officers and employees not be covered by social security, then the contribution rate will be 3 percent.)

#### **Return of Employee Contributions**

Employees who become ineligible to receive a pension benefit for any reason must have their total contributions, without interest, refunded by the plan. If the reason for payment is due to the death of the employee, then the refund is paid to the beneficiary.

#### **Early Termination Provisions**

A participant who retires or is terminated after 20 years of service shall be entitled to a deferred pension provided the participant continues paying monthly employee contributions equal to the last amount due while in active employment. Payments must continue until employee reaches the age of 55.

A participant who is involuntarily terminated after 12 years of service, but before 20, shall be entitled to a prorated benefit (based on ratio of completed service to 20 years) payable at age 60 (or immediately if already past age 60). Contributions must continue until the participant has contributed for 20 years.

#### **Disability**

The plan provides for a disability benefit if an employee incurs a total and permanent disability after completing at least 15 years of service and before attaining age 55. The benefit is calculated in the same way as the normal retirement benefit but without offset for social security benefits.

### *Elective Provisions*

#### **Surviving Spouse Benefit**

A benefit may be provided to the surviving spouse of a deceased participant who has retired, who was eligible to retire, or was killed in service. The benefit is equal to 50 percent of the pension benefit to which the participant was entitled as of the date of death. City Council may require additional contributions by employees of up to 1 percent of compensation, if deemed necessary, to fund this benefit.

#### **Elimination of Social Security Reduction**

The pension board may permit a participant to elect to receive a monthly pension benefit without any reduction for the payment of social security benefits provided that the participant pays the fund an amount equal to the difference between what was actually contributed to date and the amount which would have been contributed if the contribution rate had always been 5 percent of pay. Those participants must continue to make contributions of 5 percent after such election.

#### **Vesting Provisions**

Vesting provisions may be included to allow a terminated participant with at least 12 years of service to leave employment and receive a partial pension benefit. The benefit will commence when a participant would otherwise have become eligible for normal retirement.

**Service Increment**

A participant can receive a monthly service increment benefit in addition to the monthly pension for completing more than 20 years of service. The service increment is calculated by multiplying the number of full years of service completed in excess of 20 by 1/40th of the monthly pension benefit. Service completed after age 65 may not be counted. Eligible employees must contribute an additional 1/2 of one percent of their compensation.

**Cost-of-Living Adjustments**

The plan may provide for cost-of-living adjustments to the pension benefit, but may not permit the benefit to exceed 50 percent of the current salary being paid to non-uniformed employees of the highest pay grade.

## VII. Borough Code and First and Second Class Township Codes

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### **Borough Code**

Sections 1105 and 1131 of the Borough Code authorize the establishment of pension plans for borough employees not governed by another statute (such as Act 600). However, the Borough Code does not require that pension plans be established for these employees.

Section 1131 provides for the establishment of a pension plan for police officers of boroughs that employ less than three full-time officers that have not opted to comply with Act 600. Benefits are to be paid from a plan established and funded pursuant to Act 205, to police officers (or their surviving family) that retire or terminate employment due to disability, age, or death in the line of duty.

### **First Class Township Code**

Section 1409 of the First Class Township Code requires first class townships to establish a pension fund for its officers and serves as the governing statute for these plans, if they are not subject to Act 600. Benefits must be paid from the plan to officers who terminate employment due to age or disability, and to the families of members who are injured or killed in service. A minimum normal retirement age and a service requirement of at least 20 years of service must be established. The plan must be funded in accordance with the requirements of Act 205.

### **Second Class Township Code**

Article XIX - Township Police, of the Second Class Township Code authorizes the township's Board of Supervisors to, among other things, create a township police force and to establish a police pension fund for members of its police force. The code is the governing statute for the pension benefits offered, unless the plan is subject to Act 600. Townships are not required by the code to establish a pension funds for forces of less than three full-time officers.

If a plan is established, benefits may be paid from the plan to officers who terminate employment due to age or disability, and to the families of members who are injured or killed in service. A minimum normal retirement eligibility requirement of at least 20 years of service must be established. The plan must be funded in accordance with the requirements of Act 205.

## VIII. Pennsylvania Municipal Retirement Law

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### **General Conditions for Participation and Exit**

Any municipality, whether a borough, township, or city; a police, fire, or non-uniformed plan, can establish a plan or transfer a plan to the Pennsylvania Municipal Retirement System (PMRS), as long as its members are covered by social security.

The PMRS is governed by the Pennsylvania Municipal Retirement Law (Act 15 of 1979) which establishes an entire administrative and investment program including a choice of various levels of benefit provisions. A pension plan maintained under PMRS must be in compliance with the PMRS statute rather than Act 600 or the Third Class City Code.

If a plan transfers out of PMRS, it must then comply with Act 600 or the Third Class City Code, if applicable. A transfer out of PMRS must be approved by the governing body, a 75 percent vote of the plan members (including active and inactive participants), and by the PMRS Board of Trustees.

PMRS benefits are presented as being either defined contribution or defined benefit in nature. The defined contribution plan benefit accrues based on the level of contributions and the investment earnings credited to the fund. The benefit provided under the defined benefit approach depends upon the individual's age, years of credited service, and actual benefit formula which usually includes a salary factor. In reality, since there is a guaranteed rate of earnings for all PMRS plans, both types of plans are defined benefit plans and are therefore subject to defined benefit plan funding requirements under Act 205.

### **Provisions**

PMRS has two basic benefit plans designed by the law: one for municipal employees (Chapter 2) and one for police and firefighters (Chapter 3). However, many participating plans' benefits vary from these basic plan benefit structures. In recent years PMRS has permitted increased flexibility in benefit design.

## IX. Act 44 of 2009 — DROP

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### **Applicability**

In addition to amending Act 205, Act 44 provided a statewide authorization for Deferred Retirement Option Plans (DROPs) for any type of plan or municipality. Under DROP, a participant who has attained eligibility for retirement can sign a binding agreement to enter the DROP plan and to cease employment with the employer after completing a specified additional period of service. A monthly benefit is calculated at the participant's DROP entry and credited to the participant's DROP account, with interest, during the participant's DROP participation. At the conclusion of the DROP period, the participant's monthly benefit payments commence in the same amount as determined at DROP entry (plus any COLAs that are credited under the plan) and the lump sum value of the DROP account will be distributed to the participant.

Though DROP provisions were prevalent in local government plans, primarily those established for police or firefighters, no legal framework had been established until the passage of Act 44 in 2009. The following DROP specifications are required in DROPs established on or after September 18, 2009.

### **DROP Provision Specifications**

#### ***Eligibility / DROP Election***

Active participants, other than elected officials (prohibited from participation by the Act), who are eligible for normal retirement may elect to participate in the DROP. This is accomplished by signing a form irrevocably electing to participate in the DROP and to terminate employment with the police department at the end of a specified period.

#### ***DROP Participation***

DROP participation will begin the day following the participant's DROP eligibility and election to participate and continue for the specified period included in the pension plan document and included in the election form. The maximum DROP period for a particular pension plan may be set for any number of years, up to five. While in the DROP, the participant continues to be eligible for state mandated benefits offered to other active employees. However, DROP participants do not make employee contributions to the pension plan and do not qualify for state aid.

#### ***DROP Account, Benefit and Interest Rate***

The DROP participant's account and interest must be held by the pension trust. The benefit credited to the participant's DROP account each month is the amount of the normal retirement benefit calculated as of the DROP participation date. If applicable, annual Cost-of-Living Adjustments may be credited to the DROP account. The interest rate to be credited to the participant's DROP account will be actual rate of return on the DROP participant's account, but no less than 0% and no more than 4.5%.

#### ***Termination of Employment / DROP Exit***

Participants must terminate employment with the municipality and exit the DROP no later than the end of the maximum DROP period. Participants may terminate prior to the end of the specified period without penalty. The participant's account balance must be distributed within 45 days of election after termination as a lump sum distribution or rollover distribution.

#### ***Death During DROP Participation***

The beneficiary of a DROP participant shall receive the value of the DROP account should the participant die prior to the end of the specified period.

## X. Establishing and Amending a Pension Plan

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Do you have employees working for your municipality who are not covered by a pension plan? If so, do you want to start a new plan? If you already have a plan, do you want to expand the eligibility requirements to cover your other employees? There are many questions that need to be answered before proceeding with a new plan or expanding your current plan.

### Decisions and Options Based on Employee Group

#### *Police Employees*

If the employees you are considering covering with a pension plan are full-time police officers, the questions guiding your decision will be:

#### **Is your municipality a Third Class City?**

The Third Class City Code (see section on Third Class City Code) determines the benefits you must, and others you may, provide for your officers.

#### **Do you have three or more full-time officers?**

If you have three or more full-time officers (and do not work for a Third Class City), you must construct the plan's benefit provisions in compliance with Act 600 (see section on Act 600). If you have fewer than three full-time officers, the Borough Code or the First or Second Class Township Code may apply. Otherwise, the municipality may determine the benefit provisions at its discretion.

#### **Will you have three or more full-time officers in the foreseeable future?**

If you don't currently have three or more full-time officers but will at a future date, the plan will have to be amended at that point to comply with Act 600. The more provisions of the plan that are different from Act 600, the more difficult the transition. If you don't anticipate ever having three or more full-time officers, you need not conform with Act 600 (unless you choose to do so).

#### **Are you considering covering part-time officers?**

You may not cover part-time police officers in an Act 600 plan.

#### *Non-Police and One or Two-Member Police Departments*

#### **Do you want to give credit for past service?**

If not, you have much more flexibility in plan design and cost containment is simpler. More careful plan design is required if the plan is to credit past service to current employees. A defined benefit plan would more likely be the type of plan that will meet this goal. You will need to consult an Approved Actuary to determine how the granting of past service will affect plan costs (and to comply with Act 205).

#### **What are your primary goals and objectives in providing a pension plan for your employees?**

- Reward long-service employees
- Entice and retain employees with a valuable retirement program
- Utilize state funding
- Supplement a total benefits package

#### **Do you want to include part-time employees in the plan?**

You can include part-time employees; however, you won't be eligible for state aid for those employees.

### **Should you have a defined benefit plan or a defined contribution plan?**

A defined benefit plan is one in which the amount of monthly benefit at retirement is defined by a formula. It is payable for the lifetime of the participant, and possibly to a beneficiary as well.

A defined contribution plan is one in which the amount of the annual contribution is defined. The retirement benefit is typically payable in a lump-sum based on the value at the time of distribution.

## **Decisions Regarding Plan Type**

Whether you elect to sponsor a Defined Benefit or a Defined Contribution plan (assuming both options are available by law), there are many decisions to be made regarding plan provisions and administration. An overview appears below, along with advantages and disadvantages of each plan type.

### ***Defined Benefit Plan***

#### **Benefit formula**

- Can be based on years of service
- Can be based on final average salary
- Can be based on final average salary and years of service
- Can be a flat dollar amount

#### **Participation**

- Full-time permanent employees only
- Part-time and full-time employees
- Non-uniformed employees, police officers and/or firefighters

#### **Retirement eligibility requirements**

- Minimum age
- Minimum service
- Early retirement with a reduction

#### **Ancillary provisions**

- Total and permanent disability pension
- Death or survivor benefits
- Vested pension
- Mandatory employee contributions

#### **Advantages**

- Secure retirement income to retirees because benefit is guaranteed for life
- Easier for employees to judge level of income provided by pension plan
- Employee bears no investment burden
- Can credit past service for current employees
- State aid is provided for administrative expenses paid from plan
- If investments perform better than expected, contributions may go down or be eliminated

#### **Disadvantages**

- Employer bears investment burden; if investments underperform, contributions increase
- Depending on the formula, can be difficult to understand how much of a benefit has been earned at a given time
- Contribution levels can fluctuate
- Must employ an actuary to evaluate the plan biennially and any time benefit improvements are being considered
- Benefits are not typically portable

## ***Defined Contribution Plans***

### **Contribution rate**

- Can be a percentage of pay
- Can be a flat annual dollar amount
- Can be a weekly or hourly rate

### **Who contributes?**

- Employee mandatory
- Employee voluntary
- Employer set rate
- Employer matching contribution
- Combination

### **Participation**

- Full-time permanent employees only
- Part-time and full-time employees
- Non-uniformed employees, police officers and/or firefighters

### **Ancillary provisions**

- Vesting schedule on employer contributions
- Disability benefit
- Death benefit

### **Advantages**

- Employer bears no investment burden
- Easier for employees to understand how much of a benefit has been earned at a given point in time
- Contribution levels are predictable
- Benefits may be able to be transferred to another plan or IRA at termination

### **Disadvantages**

- Difficult for employees to predict the level of income the plan will provide at retirement
- Employees bear investment burden
- Employee is responsible for retirement planning and allocating retirement account over their lifetime
- State aid does not include allowance for administrative expenses

## **Getting Started**

Contact someone who can guide you through the plan design and implementation process who has government pension plan experience

- Pension consultant, actuary, or attorney
- Pennsylvania Municipal Retirement System
- Ask for references from other municipalities that sponsor pension plans

Have a plan document drafted (see section on Plan Documents)

- Define the benefit structure
- May establish a pension board and responsibilities
- Includes required provision of state and federal law
- Defines administrative procedures for the plan
- Adopted by ordinance
- Can be amended by ordinance in the future

Hire an investment manager/custodian for the fund

- Invest and manage assets
- Handle deposits and payments
- Maintain record of fund transactions
- Provide periodic value of assets

Appoint a Chief Administrative Officer

- Should be someone familiar with state regulations and involved in the day to day interactions with the plan

Make sure that you obtain and file the necessary forms:

- Act 205 Form prepared biennially as of January 1 every other odd-numbered year, and due to be filed 15 months later; obtain from Public Employee Retirement Commission (for defined benefit plans, form must be certified by an Approved Actuary)
- AG-385 Form prepared annually (for plans eligible to receive state aid); report employee payroll for calendar year; filing deadline is March 31 after the end of the year; forms can be obtained from the Department of the Auditor General

Starting your plan effective the beginning of a year (January 1) will entitle your municipality to state aid sooner. The state requires that a municipality fund a new plan for three full years before being eligible for state aid.

## **Plan Documents**

### ***What is a Plan Document?***

A plan document is a written compilation of all the benefits and administrative provisions of the pension plan. It includes references and provisions necessary to maintain tax qualified status under the Internal Revenue Code. It provides guidance in the administration of the plan and protects the interests of both the employer and employees. A skillfully drafted document will reduce ambiguities and the occurrences of court actions. The plan document is the legal governing document for the pension plan.

### ***Why Have a Plan Document?***

Many municipal pension plans do not have a consolidated plan document, but rather a series of ordinances, resolutions, and collective bargaining agreements containing various pension benefits. In many cases, plan ordinances mirror the language contained in the enabling statutes and amendments such as Act 600 or the Third Class City Code. However, these documents generally fail to contain the necessary detail to effectively administer the plan. Also, they may not include the language needed to be in compliance with state and federal laws.

In some cases a plan document is based on a prototype of a private (corporate) plan and contains federal regulations applicable to private plans. This can be a problem because in some cases, Pennsylvania state laws and regulations can conflict with federal laws and regulations from which municipalities are exempt.

Many lawsuits result from misinterpretation of benefits due to vague language in the ordinance or collective bargaining agreement. A consolidated plan document can protect the employer and employees by providing a clear description of benefits and administrative procedures.

It is important for your plan that a consolidated plan document be drafted and executed and that subsequent changes are enacted by an amendment to the appropriate sections of the document. It is also important that the plan document contain those provisions of the Internal Revenue Code that are required for municipalities. This prevents taxing employees on pension contributions, accruals and earnings. If a municipal pension plan were to be deemed "not qualified" under IRC Section 401(a) employees could be required to pay taxes on the pension benefits earned upon vesting and the plan sponsor could be penalized.

### ***How to Prepare a Plan Document***

Engage an experienced individual or firm to prepare an IRC Section 401(a) qualified pension plan draft document. The individual or firm may be a municipal pension consultant, attorney or plan administrator who is familiar with the state and federal laws governing your plan. They should be provided with copies of all pension ordinances, resolutions, labor contracts, arbitration awards and lawsuits pertaining to the plan. (Sometimes past practice issues need to be considered as well.) The draft should be reviewed by your solicitor and pension committee or board, if there is one, to verify that the plan provisions are in compliance with all applicable laws and regulations, and are consistent with collective bargaining agreements. When a final draft is agreed upon, the restated plan document should be formally adopted by your governing body by ordinance or resolution.

## **Amending Existing Pension Plans and Collectively Bargained Plans**

### ***Pension Plans Covering Union Employees***

Most unions bargain over pension benefits. It is important to remember two things when negotiating with a union over pension benefits. An actuarial study that complies with Section 305 of Act 205 of 1984 must be prepared and presented to the governing body prior to adopting or agreeing to changes. The study should outline the cost implications of the proposed benefit changes on the plan liabilities and the Minimum Municipal Obligation of the plan. The municipality must also verify that the changes requested by the union (or the offer by the municipality) are in compliance with applicable state and federal laws.

Once the plan modification has been studied and agreed to by both parties (or included in an arbitration award), a detailed plan amendment should be drafted and enacted by the governing body. It is not sufficient for the new or changed plan provision to just be included in the collective bargaining agreement. In addition, great care should be taken when drafting the amendment so that no conflicting interpretation arises between the plan document and the collective bargaining agreement. Also be careful to draft the plan amendments so that all possible cross-references are addressed and no conflicts arise with other sections of the plan document or pension ordinance.

Municipalities should also be aware of the impact of other employee benefits and compensation on the pension plan and vice versa. For example:

- The rate of salary increases affect the cost of the plan if pension benefits are calculated based on salary.
- For "total pay" based plans, the amount of overtime, longevity improvements, sick leave buyback or vacation accrual policy can affect the cost of the pension plan.
- If employees are eligible for post-retirement health care benefits, lowering the age for normal retirement in the pension plan can increase retiree medical costs.
- If a collective bargaining agreement provides post-retirement health care and the pension plan provides "retirement" for vesting and disability, will health care coverage be provided in all "retirement" circumstances, regardless of age?
- Coordination of disability programs (disability pension, long-term disability insurance, Heart and Lung Act benefits, social security disability, workers' compensation, etc.) may be desirable to contain costs.

The timing of benefit improvements can be very important. A benefit change would not be formally recognized until the first biennial Act 205 report is filed after the effective date of the change. For example, a change effective July 1, 2015 would not be recognized until the January 1, 2017 Act 205 Form is filed, thereby delaying recognition of the change in state aid and Minimum Municipal Obligation until 2018 (two and a half years after the effective date).

### ***Pension Plans Covering Union and Non-Union Employees (or Multiple Unions)***

Can union employees and non-union employees have different benefit structures within the same plan? Yes. You can maintain different structures within the same plan. Changes can be made to only one group (whether union and non-union, or union A and union B). The plan document must clearly define the employee groups, and the benefit provisions must address the benefit entitlement for each group.

If there are different benefits for different employee groups, it will be necessary to include a section in the plan document addressing the situation of an employee who moves from one group to another.

Some employers automatically provide benefit improvements that have been negotiated with the union to the non-union members of the plan. If this is the practice, it is especially important to amend the plan as soon as possible after the contract is signed. A signed contract officially grants benefits only to those covered by the contract. A plan amendment changes the benefit for all members of the plan.

In some cases, there may be an advantage to simply maintaining separate plans for different employee groups. This may be the case if negotiations with a union focus heavily on the plan costs. It may be difficult to identify the portion of the total cost attributable to only the bargaining group. Another reason for maintaining separate plans may be that the structures are totally different, such as defined benefit versus defined contribution.

A municipality that is considering amending their pension ordinance to either start a new plan for a certain group of employees or establish a new plan for new hires of the employee group should be careful in structuring the plan amendment language to ensure that it would not be viewed by the state as a new plan subject to the three-year waiting period for state aid.

Again, getting good advice from someone experienced in government pension issues can help avoid potential problems.

## **XI. Potential Plan Termination or Plan Transfers**

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### **Reasons**

Although rare in the government pension realm, from time to time, pension plans may need to be terminated. Examples of circumstances that may prompt a municipality to consider terminating their plan might be:

- Dissolution of a police department
- Elimination of a department or the sale of a unit which was covered by its own plan
- Freezing the plan participation requirements. New employees would become participants in a new plan.

### **Considerations**

There is very little guidance on whether a pension plan should be terminated, and if so, the procedures for terminating a pension plan in Pennsylvania. A common situation in which a municipality would consider terminating a plan would be a change in terms of police coverage, such as entering a purchase of service arrangement or utilizing only part-time officers.

Regardless of the circumstance, careful consideration should be given to whether or not the plan should be formally terminated. If there is any possibility that a full-time employee will be hired in the foreseeable future, the plan should not be terminated. To reestablish a plan the municipality may have to fund the plan for three years without the benefit of state aid. Should the municipality believe that in the future a full-time employee may be hired, consideration should be given to continuation of the plan. The plan may continue as long as a current liability (i.e., vested benefit, retirement benefit, disability benefit, survivor benefit) or an expected liability (i.e., new hire) remains. In this case, the plan would continue to pay benefits as they become due despite the fact that there are no remaining active employees in the plan. Alternatively, if no future participants are expected and there are sufficient assets, the municipality may consider purchasing annuities to satisfy existing plan obligations.

### **Distribution of Plan Assets**

If a municipality eliminates their police department, enters into a purchase of service agreement or participates in a regional department, and the municipality's officers are hired by that other municipality or regional department, the plan benefits earned by the officers and plan assets of the original pension plan may be transferred to the other municipality's pension plan. (Refer to the section on Regional Police Departments and Purchase of Service Agreements.) In any event, the plan should not be terminated in this case until all transfers have been made.

If a decision has been made to terminate the original pension plan, after assets have been transferred to any successor plan (to cover liabilities of transferred officers, if applicable) and/or annuities have been purchased to cover benefit obligations for current inactive participants, a portion of the remaining funds in the plan may be returned to the municipality based on their contributions to the plan (assuming the plan document does not prohibit this). If any remaining plan assets are considered to have come from state funding, a portion may need to be returned to the Dept. of the Auditor General.

## XII. Recordkeeping

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The most efficient method of maintaining records and being prepared for an audit is by keeping a central filing system of all pension-related information. You may be able to obtain an administrative manual and/or a set of administrative forms from your pension consultant or plan administrator.

The following is a list of the types of information that should be maintained for the pension plan and will be needed for audits. The list may not be comprehensive. Maintain all information that you feel may need to be referenced.

### **Active Members of Plan**

- Enrollment Form for each member (including birth date, hire date, plan participation date, and beneficiary)
- Annual salary (gross pay and pension wages, if different)
- Annual employee contribution records and contribution balances with interest
- Records regarding breaks in service
- Beneficiary changes
- Documentation of military service purchase
- Domestic Relations Order

### **Inactive Members of Plan**

- Letter of resignation/Application for retirement
- Final Average Pay calculations
- DROP agreements
- Accumulated contribution records
- Retirement or Vested Benefit Calculation and options provided
- Beneficiary designation and current address
- Contribution Refund Calculation and documentation of payout
- Signed benefit election form

### **Financial Statements of the Plan**

- Annual account values (market value, cost value, etc.) at end of each plan year
- Asset balance categorized by type of investment
- Transaction ledgers (contributions by source, retiree payments, administrative expenses paid, etc.)
- Investment earnings (interest, dividends, realized and unrealized gains and losses, etc.)
- Annual reconciliation of plan assets
- Audit reports (state and local)

### **Plan Reports and Filings**

- Forms prepared for filing with Department of Auditor General or Public Employee Retirement Commission
- Minimum Municipal Obligation (MMO) calculations
- Cost studies
- Correspondence regarding plan benefits, costs or audit problems

**Plan Documentation**

- Plan document
- Pension ordinances
- Plan amendments
- Collective bargaining agreements
- Resolutions
- Arbitration awards
- Pension lawsuits
- Correspondence regarding interpretation of plan provisions
- Private letter ruling
- Determination letter

## XIII. Common Administrative Concerns

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### **Contracting with Professional Service Providers**

Prior to the passage of Act 44, no specific rules existed with regard to a municipality contracting with professional service providers such as attorneys, actuaries, investment managers, custodians, etc. to provide services for their municipal pension plan(s). In an effort to minimize the opportunity for “pay for play” in these instances and maximize transparency in the process, the legislature included Section 7-A, Standards for Municipal Pension Systems, in Act 44 of 2009.

Subsection 705-A of Act 44 requires municipalities to obtain annual disclosures from their existing pension service providers regarding political contributions, gifts to employees or officials of the municipality or pension system, employment of any third-party intermediary, agent, or lobbyist, and the existence of any financial relationship with any official of the municipality or its pension system. In addition, Subsections 702-A through 707-A provide very specific procedures that must be used to procure a professional service contract. A summary of these requirements appears below.

#### ***Section 702: Procurement for Professional Services Contracts***

##### **Procedures**

Each municipal pension system must develop procedures to select the most qualified person to enter into a professional services contract, to ensure the availability of a contract is advertised, and to include applications and disclosure forms in submitting proposals and receiving the award of a contract.

##### **Advertisement**

The advertisement of the availability of a contract must specify the services to be contracted, procedures to compete for contract, and required disclosures.

##### **Review**

A person’s qualifications, experience, expertise, and fees must be reviewed when selecting the most qualified person.

##### **Personnel**

Contractor shall disclose the names and titles of each individual who will be providing professional services and also indicate whether the individual is a current or former official or employee of the municipality or pension system, whether he/she has been a lobbyist, and a what responsibilities he/she will have in regards to the contract.

##### **Conflict of Interest**

The municipal pension system must adopt policies relating to conflicts of interest in the proposal/contract process.

##### **Public Information**

Following the award of a contract, all applications must be made public except for certain information protected by law.

##### **Increase**

A contract cannot be amended to increase costs by more than the greater of 10% or \$10,000 unless the increase and a written justification are made public and posted on the municipality’s website at least 7 days prior to effective date of increase.

##### **Notice and summary**

Relevant factors that resulted in the award of the contract must be summarized and included in or attached to the contract. Within 10 days of awarding the contract, this information and a copy of the contract and original application must be given to all unsuccessful applicants and posted on the municipality’s website. Posting must also occur at least 7 days prior to the execution of the contract.

### ***Section 703: Agents; solicitation***

#### **Agents**

Anyone entering into a contract with the pension system must disclose employment or compensation of third-party intermediaries, agents, or lobbyists to communicate with a municipal official.

#### **Limitation on Communication**

Upon advertisement for a contract the contractor may not cause or allow a third party to communicate with officials or employees except for requests for technical clarification.

### ***Section 704: Disqualification***

#### **Contributors**

A person or entity that made a contribution to a municipal official or candidate in the past two years may not enter into a professional services contract.

#### **Relationships**

A person or entity entering into a contract may not have a direct financial, commercial, or business relationship with any official of the municipality or pension system unless the pension system consents in writing to the relationship following full disclosure.

#### **Gifts**

A person with a contract may not offer or give a gift having more than a nominal value to any official, employee, or fiduciary of a pension system.

### ***Section 705: Disclosure***

#### **Contractors**

A person or entity with a contract must disclose all contributions to which all of the following apply: Contribution of at least \$500 made within the last five years by an officer, director, or executive-level employee or owner of at least 5% of the entity to a candidate for public office or an individual who holds office or a political committee for a candidate for public office in the Commonwealth. This information must be updated annually.

#### **Additional Disclosure**

A person or entity with a contract must disclose detailed information about the contributions referred to above, about gifts to officials or employees of the pension system or municipality, about any third-party intermediaries, and about the existence of any financial relationship under Section 704.

#### **Forms**

Required disclosure must be made on a form prepared by the pension system, attached to the contract, and posted on the system's website.

#### **Penalties**

Contract of a person that knowingly makes a material misstatement or omission in a disclosure form will be voided, with this person prohibited from entering into a contract for up to three years.

### ***Section 706: Duty to Act***

A person that has or has applied for a contract who becomes aware of a potential or actual conflict of interest must promptly disclose and eliminate it.

### ***Section 707: No Preemption***

A stricter code of ethics in place or established by a municipality is not preempted by this chapter.

## **Audits by the Auditor General's Office**

Along with the opportunity of receiving state funding for municipal pension plans comes the necessity of an audit by the Department of the Auditor General. State audits are typically performed every two or three years.

The purpose of the audit is to verify that state funds have been properly used and the pension plans are being administered according to applicable statutes and generally accepted accounting principles. Accordingly, the job of the auditors is to verify compliance with state laws (Act 205, Act 600, Third Class City Code, etc.), ensure proper financial accounting records are maintained, and ensure that accurate and complete personnel records are kept. Also, they will review forms and filings with state agencies for accuracy and timeliness.

The following are many of the forms and documents that the auditor will review during the state audit:

- Act 205 Form
- AG-385 Form
- Act 205 Recovery Program Election Form PC-204D
- AG-490 and AG-64
- Annual Act 44 Professional Service Provider Disclosures
- Conflict of Interest policy
- Procurement of professional services procedures
- Minimum Municipal Obligation (MMO) and actual contributions
- Pension Ordinances
- Labor Contracts
- Plan Document
- Actuarial Valuation Report
- Account Statements and Reconciliation of Plan Assets
- Benefit Calculations for retired and terminated participants
- Trust Document
- Insurance Policies and Contracts
- Personnel information for active and retired or terminated employees

The municipality generally receives notice of an impending audit and a list of the information that the auditors intend to review for the audit (much of which is listed above). The length of the audit depends largely on the completeness and organization of the pension records. When the field audit is complete, the auditor will schedule an exit conference with municipal officials. At that time, the auditor will discuss any problems uncovered and provide a written summary of the preliminary findings. Once the field audit is completed, the information is reviewed by Department of the Auditor General Management prior to issuance.

If the Auditor General's audit reveals that there are any areas of noncompliance or internal control deficiencies, the report will contain a Finding for each outlining the problem and a Recommendation describing the corrective action the department recommends to resolve the problem. If the problem is significant and timely corrective action is not taken by the municipality to resolve it, the Auditor General may issue an Order to Show Cause forcing compliance. If the Order is ignored as well, state aid may be withheld for the entire municipality.

If you suspect that a Finding is inaccurate or based on incomplete information, you may try to collect supporting documentation (items which may not have been given to the auditor during the audit) and prepare a written explanation justifying the municipality's position. However, unless it relates to a potential withholding of state aid, the Auditor General is not compelled to provide a response accepting or rejecting conclusively the municipality's resolution. Such confirmation or rejection of the resolution will be addressed in the next audit.

### **Common Audit Findings**

**Failure to budget and pay the Minimum Municipal Obligation.** The Minimum Municipal Obligation (MMO) was not prepared, not prepared correctly, not budgeted, not paid, or a combination of these. The MMO must be prepared by September 30 of the previous year. The MMO amount should be a line item in the budget, and it must be paid by the end of the plan year. If the MMO is not prepared in a timely fashion, the regulation states that the MMO must be prepared using the latest information available. If the MMO is not paid by the end of the year, interest must be added.

**Late Deposit of State Aid.** State Aid was not deposited within the 30-day period allowed. You must deposit an amount equal to the interest lost because of the late deposit.

**Pension Benefits Not in Compliance With Act 600/Third Class City Code/Borough Code, etc.** A contract or an ordinance includes a benefit provision that is not permitted under the plan's governing statute. Resolving this kind of problem can be tricky. It is advisable to consult your solicitor and pension advisor.

**Actuarial Study Not Prepared Prior to Benefit Modification.** An actuarial cost study outlining the cost impact of the benefit change was not prepared before the change was enacted as required by Act 205. You should consult your actuary to complete the necessary study.

**Incorrect Calculation of Retirement Benefit.** The amount of monthly benefit for a retiree was calculated incorrectly. This could occur for many reasons, including: incorrect salary, inappropriate pay, service credits calculated incorrectly, mathematical error, or the benefit formula was improperly applied. Before you recalculate a benefit, you should verify the accuracy of the information received by the auditor.

**Incorrect Data on Certification Form AG-385.** The municipality improperly certified ineligible employees, over-certified payroll on Certification Form AG-385 or omitted eligible participants resulting in an overpayment or underpayment of state aid. In order to be eligible for certification, an employee must have been employed on a full-time basis for at least six consecutive months during the year and must have participated in an eligible pension plan during the certification year. Errors on this form are very common. Read the form instructions carefully and call to verify any answers you are unsure of. Errors resulting in overpayment of state aid require a refund to the state with interest. Underpayments resulting from errors may be recovered.

**Improper Elimination or Reduction of Member Contributions.** In an Act 600 plan, the municipality failed to obtain an actuarial study to determine if police contributions could be reduced or eliminated below the mandated rate (if required by the plan document)and/or the municipality did not pass an ordinance or resolution authorizing the reduction or elimination. The study and resolution should be done prior to the beginning of the year in question (usually after the MMO is calculated).

### **Domestic Relations Orders**

A plan administrator is frequently charged with the duty of deciding whether to accept or reject a Domestic Relation Order drafted with regard to the equitable distribution of a participant's pension benefit. In the case of a defined benefit plan especially, where no "participant account" exists that could be easily divided and distributed, there are many factors that must be considered. First and foremost, the Order must not require any payment to be made from the pension plan that would otherwise not have been payable on behalf of the participant. Next, the Order must define the amount and duration of the benefit payments for the alternate payee in a manner that is administratively feasible. (For example, it should address how payments are affected by the death of the participant and by the death of the alternate payee.) The alternate payee's responsibility to pay any applicable taxes on payments received from the plan should also be addressed. It is important to note that if payments are made to an ex-spouse through a court order other than a domestic relations order specifically pertaining to the distribution of the participant's pension benefit, the participant will remain responsible for paying taxes on the full benefit regardless of the portion the participant receives.

Problems arise most frequently because the lawyers handling the divorce are unfamiliar with the underlying statutory provisions that govern the pension plans. Except in rare circumstances, police and firefighter pensions in Pennsylvania are governed by very specific statutes. Although a plan administrator must recognize the rights of an alternate payee under state domestic relations laws, a particular order can only be approved if it complies with the underlying legislation and the terms of the plan. Plan administrators frequently consult their pension consultants, labor attorneys, or solicitors for advice regarding the approval of a Domestic Relations Order.

## **Pension Forfeitures**

Another difficult situation for pension plan administrators is the handling of pension entitlements for pension plan participants who may be guilty of certain crimes. The Pension Forfeiture Act calls for forfeiture of benefits in certain situations.

The Act:

- Applies to all elected or appointed public officials or public employees of the State or any political subdivision.
- Disqualifies any public official or employee who is convicted or pleads guilty or no defense to a crime related to public office or employment from receiving any pension benefit, except return of contributions without interest. Payments are also suspended during appeal.
- Permits the appropriate retirement board to retain the participant's contributions and interest for the purpose of paying any fine imposed on the participant or for the repayment of misappropriated funds.
- Specifies the crimes that fall under the legislation. Those crimes which apply at the levels indicated in parentheses, with section references to Title 18 (Crimes and Offenses) of the Pennsylvania Consolidated Statutes, are:
  - Section 3922 - theft by deception (M1)
  - Section 3923 - theft by extortion (M1)
  - Section 3926 - theft of services (M1)
  - Section 3927 - theft by failure to make required disposition of funds received (M1)
  - Section 4101 - forgery
  - Section 4104 - tampering with records or identification
  - Section 4113 - misapplication of property (M2)
  - Section 4701 - bribery in official and political matters
  - Section 4702 - improper influence
  - Section 4902 - perjury
  - Section 4903(a) - false swearing
  - Section 4904 - unsworn falsification to authorities
  - Section 4906 - false reports to law enforcement
  - Section 4909 - bribery of witness or informant
  - Section 4910 - tampering with evidence
  - Section 4911 - tampering with public records
  - Section 4952 - witness intimidation
  - Section 4953 - retaliation against witness
  - Section 5101 - obstructing administration of law or government
  - Section 5301 - official oppression
  - Section 5302 - speculating or wagering on official action
  - Sections 3121-3129 - Sexual Offenses, when committed by a school employee against a student
  - Violation of PA Personal Income Tax Law

*M1 = Misdemeanor of first degree M2 = Misdemeanor of second degree*

## **XIV. Calendar of Administrative and Reporting Requirements**

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This calendar provides reminders for important pension plan filing deadlines and administrative tasks for local governments. It is intended to serve as a guideline and may not be comprehensive with regard to your specific municipal pension needs.

### **JANUARY**

- January 1 valuation date for most pension plans (required for municipalities on odd-numbered years and counties on even-numbered years)
- Can begin compiling prior year-end data (census, payroll, assets etc.) to submit to actuary or pension administrator for preparing valuation or other reports

### **MARCH**

- Biennial Act 205 Actuarial Valuation Report forms due to be filed with Public Employee Retirement Commission (PERC) by the last business day for all municipal pension plans (even-numbered years)
- Form AG-385 due to be filed with Department of the Auditor General by last business day for municipalities eligible for state pension aid

### **APRIL**

- Form AG-490 to be received by Department of the Auditor General before April 1 for municipalities eligible for ad hoc COLA reimbursement under Act 147 of 1988 (applicable to certain uniformed participants who retired before 1985)

### **AUGUST**

- Ad hoc COLA reimbursement checks distributed around mid-month for eligible municipalities under Act 147 of 1988 (applicable to certain uniformed participants who retired before 1985)
- PERC sends municipalities Act 205 Recovery Program Election forms with new Distress Scores (even-numbered years)

### **SEPTEMBER**

- Minimum Municipal Obligation (MMO) calculation of next year's contribution for all municipal pension plans must be submitted to governing body by end of month
- Municipal pension state aid distributed around last week or two of the month

### **OCTOBER**

- PC-200 Questionnaire and Reporting Form Request must be submitted to PERC by mid-month (in odd-numbered years)
- Municipal pension state aid must be deposited to pension plans within 30 days of receipt

### **NOVEMBER**

- Any revisions to MMO calculations for next year must be adopted before the final municipal budget is adopted
- Act 205 Recovery Program Election form due to be filed with the PERC by the end of the month for municipalities eligible for and electing any remedies (even-numbered years)

## **DECEMBER**

- For Act 600 police pension plans, a resolution needs to be passed for next year if member contributions are going to be reduced below the mandated rate
- Minimum Municipal Obligation (MMO) must be paid by end of month to avoid interest penalty (after that date, interest is charged on unpaid balances from the beginning of the year in which it was due) - remember to use the amount calculated and budgeted the preceding year, and deduct any state received and allocated to the plan

## **ANYTIME REMINDERS**

- Are all pension plan participants' beneficiary designations up-to-date?
- Are any retirees due for a COLA this year?

## XV. Reference Statutes

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The following is a list of some of the Commonwealth statutes which affect pension plans in cities, boroughs, towns and townships.

- Act 205** Municipal Pension Plan Funding Standard and Recovery Act, Act of December 18, 1984, P.L. 1005, No. 205, as amended, 53 P.S. 895.101, et seq. The Act provides for actuarial and financial reporting for municipal pension plans, actuarial funding requirements for municipal pension plans, annual distribution of state aid to municipalities to offset employee pension costs, and recovery program for financially distressed pension plans.
- Act 600** Police Pension Fund Act, Act of May 29, 1956, P.L. (1955) 1804, No. 600, as amended, 53 P.S. 767, et seq. All boroughs, towns, and townships with three or more full-time police officers, or a regional police pension plan must establish a police pension plan in accordance with the provisions of this act. In addition, boroughs, towns, and townships with fewer than three full-time police officers may establish their plans in accordance with this act.
- Act 317** Third Class City Code, Act of June 23, 1931, P.L. 932, No. 317, as amended, 53 P.S. 39301, et seq. Third class cities are required to establish a pension plan for police officers and paid firefighters, and may elect to establish a pension plan for non-uniformed employees, pursuant to the provisions of this Act.
- Act 331** First Class Township Code, Act of June 24, 1931, P.L. 120, No. 331, as amended, 53 P.S. 56409, et seq. First class townships with fewer than three full-time police officers are required to establish a police pension plan pursuant to the provisions of this code.
- Act 69** Second Class Township Code, Act of May 1, 1933, P.L. 103, No. 69, as amended, 53 P.S. 65595, et seq. Second class townships that have fewer than three full-time police officers and elect to establish a police pension plan must refer to the provisions of this code.
- Act 581** Borough Code, Act of February 1, 1966, P.L. 1656, No. 581, as amended, 53 P.S. 46131, et seq. Boroughs with fewer than three full-time police officers that elect to establish a police pension plan must refer to the provisions of this code.
- Act 15** Pennsylvania Municipal Retirement Law, Act of February 1, 1974, P.L. 34, No. 15, 53 P.S. 881.101, et seq. Municipalities and municipal authorities may elect to have the Pennsylvania Municipal Retirement System administer their pension plans as an alternative to a plan administered by the municipality.
- Act 66** Public Employee Retirement Commission Act, Act of July 9, 1981, P.L. 208, No. 66, 43 P.S. 1401, et seq. This act established a commission to make a continuing study of public employees' retirement and pension systems.
- Act 164** Probate, Estates and Fiduciaries Code, Chapter 73, Fiduciaries Investments, Act of June 30, 1972, P.L. 508, No. 164, 20 Pa. C.S.A. 7301, et seq. (commonly referred to as the Fiduciaries Investment Act) This act details various requirements for the investment of funds and the conduct of fiduciaries.
- Act 140** The Public Employee Pension Forfeiture Act, Act of July 8, 1978, P.L. 752, No. 140, 43 P.S. 1311, et seq.
- Act 147** Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, 53 P.S. 896, 101, et seq. This act provides for a postretirement adjustment (cost of living increase) for eligible retired police and firefighters who were receiving benefit payments before January 1, 1985.
- Act 64** Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment, Act of June 19, 2002, P.L. 434, No. 64, 53 P.S. § 896.401, et seq. providing an additional post-retirement adjustment beginning with annuity payments after June 30, 2002, to eligible retired municipal firefighters and police officers who were receiving benefit payments before January 1, 1996.

- Act 41** The Act of March 30, 1988, P.L. 312, No. 41, 53 P.S. 65515. This act provides for supervisors in second class townships to be eligible to participate in the township pension plan under certain conditions.
- Act 51** Act of October 9, 2009, No. 51, 53 P.S. § 891 et seq. amending The Emergency and Law Enforcement Personnel Death Benefits Act, Act of June 24, 1976, P.L. 424, No. 101 to provide benefits to survivors of emergency personnel who are killed in the line of duty, and expressly repealing the killed in service benefit formerly mandated by Act 600.
- Act 62** Home Rule Charter and Optional Plans Law, Act of April 13, 1972, P.L. 184, No. 62, as amended, 53 P.S. Section 1-101, et seq.
- Act 44** Act of September 18, 2009, P.L. 396, No. 44 - the most significant amendment to the Municipal Pension Plan Funding Standard and Recovery Act, Act of December 18, 1984, P.L. 1005, No. 205 since its enactment.

## XVI. Glossary of Pension Terminology

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### **Accrued Benefit**

The portion of the participant's retirement benefit that is attributable to service completed before the calculation date. The calculation typically uses actual service as of the calculation date and may involve other factors such as average pay at the determination date and projected service through the retirement eligibility date.

### **Actuarial Accrued Liability**

The portion of the actuarial cost assigned to prior years.

### **Actuarial Assumptions**

Factors used by the actuary to forecast future events. These factors include items relating to future economic conditions, the survival of the participants and their beneficiaries, and the length of employment.

### **Actuarial Cost Method**

A means of assigning costs to periods of employment. This method is used to determine a funding level that will provide sufficient assets to pay benefits for each participant upon retirement. Act 205 specifies that the entry age normal cost method, as described in the Act, should be used for this determination.

### **Actuarial Gain or Loss**

The effect on the actuarial accrued liability of differences between events as predicted by the actuarial assumptions and those that actually occurred. This difference can increase or decrease the contribution in future years.

### **Actuarial Present Value**

The lump sum value that is equivalent to an expected series of future payments. This value is determined by using the actuarial assumptions. An actuarial present value, as of the valuation date, represents the amount of funds that would be sufficient to provide the series of payments, if experience precisely matches the actuarial assumptions.

### **Actuarial Value of Assets**

The value of current plan assets used by the actuary to evaluate the current funding status and determine future funding requirements. Pennsylvania Code, Title 16, Part IV, Section 203.2(a) requires that this value be between 80 and 120 percent of the fair market value of the assets.

### **Approved Actuary**

A person who has at least five years of actuarial experience with public pension plans and who is either enrolled as a member of the American Academy of Actuaries or enrolled as an actuary pursuant to the Federal Employee Retirement Income Security Act of 1974.

### **Amortization Payment**

The annual payment required to eventually eliminate the unfunded actuarial accrued liability according to the schedule established in Act 205.

### **Chief Administrative Officer**

The person who has primary responsibility for the execution of the administrative affairs of the municipality in the case of a municipality, or of the pension plan in the case of a pension plan, or the designee of that person.

### **Funding Adjustment**

Occurs when the actuarial value of assets exceeds the actuarial accrued liability; it is defined by Act 205 as 10 percent of the excess. This adjustment reduces the amount that must be contributed to the pension plan.

### **General Municipal Pension System State Aid**

Annually, municipalities receive a portion of the insurance premium tax levied on casualty and fire insurance companies headquartered outside of Pennsylvania. These taxes are distributed according to formulae contained in Act 205.

**Minimum Municipal Obligation (MMO)**

The MMO determines the amount of money that must be contributed to a pension plan by a municipality for a given year. The calculation of this amount uses the normal cost, anticipated administrative expenses, amortization payment or funding adjustment, and anticipated employee contributions to determine a municipality's contribution requirement. General Municipal Pension System State Aid may be used to make the contribution.

**Normal Cost**

The actuarial cost assigned to a given year to pay for the portion of the anticipated benefit derived from service during that year.

**Unfunded Actuarial Accrued Liability**

The amount by which the actuarial accrued liability exceeds the actuarial value of assets. A valuation will identify the value of changes in the unfunded actuarial accrued liability that result from changes in plan benefits, actuarial assumptions, or actuarial gains and losses.

**Vesting**

The participant's non-forfeitable right to receive a benefit, provided that the participant survives until benefit eligibility.

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