Report to the
General Assembly and Governor of the
Commonwealth of Pennsylvania

PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION

RECOMMENDATION OF ACTUARIAL FUNDING STANDARDS AND A RECOVERY PROGRAM FOR MUNICIPAL PENSION SYSTEMS

Commonwealth of Pennsylvania
January 1983

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PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION

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COMMONWEALTH OF PENNSYLVANIA

PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION

HARRISBURG
17120

January 25, 1983

To Members of the Pennsylvania General Assembly and
Governor Thornburgh:

The law establishing the Public Employee Retirement Study Commission, Act 66 of 1981, directed the Commission to recommend legislative reforms for municipal pension systems during its first year of operation. In setting this priority for the Commission, the General Assembly recognized the urgent need to address the increasing threat of insolvency on the part of a number of municipal pension funds.

On December 8, 1982, the Commission responded to this legislatively established priority by adopting the recommendations set forth in this report. As specifically directed by the General Assembly, the recommended reforms mandate compliance with an actuarial funding standard by all municipal pension systems and implement a comprehensive recovery program for financially distressed municipal pension systems. The recommended recovery program entails the adoption of remedial measures by municipalities and the provision of short-term financial assistance by the Commonwealth in meeting the required actuarial funding.

Unfunded accrued liabilities of municipal pension funds in Pennsylvania have been increasing by more than $150 million annually and currently exceed $2.5 billion. Continued inattention can only compound the present problem. Prompt legislative action is essential to avert severe fiscal crises in many of Pennsylvania's municipalities due to financially troubled pension funds.

Legislation to implement the Commission's recommendations will be introduced early in the 1983 session of the General Assembly. I join with my fellow Commission members in stressing the urgent need for your timely consideration of these recommended municipal pension reforms intended to restore financial health to municipal pension systems in Pennsylvania.

Sincerely,

G. B. Seavers

Gilmore B. Seavers
Chairman

TABLE OF CONTENTS

INTRODUCTION

In establishing the Public Employee Retirement Study Commission, the General Assembly directed the Commission to "formulate and recommend passage of legislation to mandate actuarial funding standards and establish a recovery program for municipal pension systems determined to be financially distressed." The Commission's response represents a comprehensive remedial program to ensure the financial solvency of municipal pension systems in the Commonwealth. The municipal pension system remedial program recommended by the Commission provides for: (1) the implementation of an actuarial funding standard mandating contributions to municipal pension funds calculated in a uniform manner; (2) the classification of all municipal pension systems according to their relative levels of financial distress through a uniform evaluation process using statistically comparable actuarial and financial indicators; and (3) the operation of a recovery program for a limited period of time to facilitate compliance with the actuarial funding standard in the more financially distressed municipal pension systems and to generate various reform measures for those municipal pension systems.

Actuarial Funding Standard

The actuarial funding standard proposed by the Commission for all municipal pension systems requires full actuarial funding for employee pension obligations. To effect that objective, the Commission recommends adoption of a uniform actuarial valuation method and specification of a range for major actuarial assumptions used in calculating the required contributions to municipal pension funds. Upon implementation of the actuarial funding standard, aggregate contributions to municipal pension funds will provide for payment of normal costs and amortization of any unfunded accrued liability. Monitoring compliance with the actuarial funding standard will be accomplished by the Commission in conjunction with its review of biennial actuarial valuation reports to be submitted for all municipal pension systems.

Financial Distress Determination

To implement a recovery program for municipal pension systems determined to be financially distressed, the Commission recommends annual determinations of financial distress under a highly structured, quantifiable assessment program that evaluates both the aggregate actuarial condition of pension funds and the general fiscal conditions of individual municipalities. The Commission proposes that the relative financial distress of municipal pension systems determine the various remedies to be made available to municipalities under the recovery program.

Recovery Program

The recovery program for municipal pension systems recommended by the Commission entails restructuring the existing state aid programs for municipal pension systems. The Commission recommends that a general municipal pension system state aid program be established to replace the current state aid programs under which portions of the foreign casualty and foreign fire insurance premium tax proceeds are distributed by formula to municipalities to offset pension costs for police officers and paid fire-fighters. The proposed general municipal pension system state aid program would be financed by the total proceeds from the foreign casualty insurance premium tax and by the portion of proceeds from the foreign fire insurance premium tax allocated to municipalities to offset pension costs for paid firefighters. Allocations to municipalities under the general municipal pension system state aid program would be based on the number of active employees participating in established pension systems and weighted to reflect the difference in cost for pension plans for police officers. The Commission recommends that the difference in cost for pension plans for paid firefighters be reflected by augmenting allocations of general municipal pension system state aid to municipalities with pension funds for paid firefighters with per firefighter allocations of aid to be financed from the proceeds of a surcharge on the premiums of foreign fire insurance policies written on properties located in those municipalities. The proposed restructuring of the existing state aid programs for municipal pension systems thus initiates municipal allocations related to employee pension costs.

The recovery program recommended by the Commission also provides for implementation of remedial measures in accordance with the degree of financial distress determined to exist in the pension systems of individual municipalities. The remedial measures afforded to municipalities under the recovery program are designed to facilitate compliance with the actuarial funding standard and include interim relaxation of the actuarial funding standard, expansion of municipal capacity to raise revenues to meet pension fund obligations and revision of pension benefit plans to reduce future municipal costs. The remedial measures of the proposed recovery program also include a temporary program to provide supplemental state assistance for financially distressed municipal pension systems after the revised state aid program and local remedies have been implemented. The supplemental state assistance will fund a percentage of the difference between existing contributions and the contributions needed under the actuarial funding standard. The actual percentage of supplemental state assistance provided will be directly related to the financial distress determined to exist in the individual municipal pension systems. The Commission recommends that the supplemental state assistance program be funded through annual general fund appropriations, not to exceed $35 million, commencing in 1987. Allocations of supplemental state assistance to the municipalities will diminish as the actuarial condition of their pension funds improves over time. To accelerate improved actuarial conditions in financially distressed municipal pension systems, allocations of supplemental state assistance will be augmented by allocations of monies redirected from the general municipal pension system aid program. The supplemental state assistance program will terminate upon the absence of eligible recipients in any year, or if that does not occur, will automatically terminate after fifteen years to ensure the Commonwealth does not incur an ongoing financial commitment in this area of local government. Prior to 1987, the proposed recovery program also provides for emergency loans to municipalities facing imminent default in meeting employee pension payments. The emergency loans are to be repaid from future allocations of Commonwealth monies to the recipient municipalities.

The specific recommendations of the Commission on the development of a remedial program for municipal pension systems are set forth in the following policy discussion. The discussion is presented in three parts which represent the major components of the remedial program. Implementation of actuarial funding for municipal pension systems in the Commonwealth is addressed in Part I. Part II concerns the determination of financially distressed municipal pension systems, while Part III addresses the recovery program for those pension systems. A composite of the Commission's recommendations developed in response to the statutory mandate contained in Act 66 of 1981 is attached as an appendix to the report. Introduction of legislation to implement the Commission's recommendations is planned for early in the 1983 session of the General Assembly.

PART I

ACTUARIAL FUNDING STANDARDS

THE CONCEPT OF AND THE PURPOSE FOR ACTUARIAL FUNDING

In determining the appropriate funding standard, the Commission feels that it is necessary to clarify the concept of actuarial funding. With the establishment of a public pension plan and the promise to public employees of eventual pension benefits, a liability to each public pension plan member is assumed by the plan. Once public pension plan liabilities are undertaken, there arises a need to provide financing to match the liabilities whenever they are recognized.

The method of financing depends primarily on the basic nature of the benefit plan. Benefit plans can be broadly differentiated as either defined contribution plans or defined benefit plans. The two types of plans can be distinguished by which element is fixed and which element is variable. The two elements are the benefit amount and the financing.

In a defined contribution plan, the financing of the public pension plan is fixed as a set dollar amount or percentage of pay and the amount of the eventual pension benefit is variable and dependent chiefly on the amount of financing. Since the obligation undertaken in a defined contribution plan (sometimes termed a "money purchase" plan) is to make contributions in a set percentage rate or dollar amount, the accruing liability of the plan is limited to making specified contributions at specified points in time and the total accrued liability of the plan is limited to the amount of the accumulated assets of the pension fund (contributions, investment earnings and any turnover or other experience gains).

In a defined benefit plan, the amount of the eventual pension benefit is fixed as a set dollar amount or percentage of covered salary for some period of service (range of final salary to career average salary), and the financing of the plan is variable, dependent on the actuarial funding method chosen. Since the obligation undertaken with a defined benefit plan (sometimes termed a "formula" plan) is to provide a benefit of a predetermined amount at the time of retirement, the financing method will be more complex and will inherently have more variations.

With a defined contribution plan, the additional liability for the pension plan is equal to, and is recognized simultaneously with, the payment of contributions or the occurrence of turnover or other experience gains. With a defined benefit plan, the recognition of an additional liability for the pension plan is a more difficult concept. With a defined benefit plan, a distinction must be drawn between the point in time when the liability for a retirement annuity is created and when the payment of that liability is due and any failure to make it would result in a default on the obligation. It is the nature of pension funds that there typically will be a time lag of as much as 30 or 40 years between the first day of public employment when an employee begins to acquire service credit and thereby establishes a right to an eventual pension benefit and the day after an employee's active service ends and the employee has reached at least the minimum specified retirement age when the employee's right to a pension benefit fully accrues and payment of the pension benefit begins. Looking at a pension benefit at the end of the retired employee's lifetime, the total liability for the employee's benefit and the total amount expended paying the benefit over the employee's retired lifetime will be the same. This in actual dollars will always equal the following:

(1) the amount of retirement benefits paid to employees;

(2) plus the administrative expenses incurred in operating and investing the fund;

(3) less any investment income earned on any invested assets of the pension fund.

Unless employee contributions toward the pension benefit are required and unless assets are accumulated during the working lifetime of the employee for investment, the employer who established the pension plan and fund will be responsible for this total amount.

A policy maker has a choice about when to recognize the pension benefit liability. A decision about when to recognize the liability for pension benefits has consequences affecting the allocation of the burden of financing the liability over time and the allocation of the burden of financing the liability between available financing sources. The Commission recognizes that policy makers dealing with public pension funds have more latitude in deciding when to recognize, and thereby when to finance, the liability for pension benefits than do policy makers dealing with private industry public pension funds because of the current absence of federal legislation governing public employee pension plans.

With respect to defined benefit plans, there is a continuum of funding methods ranging from the lengthy deferral of the recognition and financing of pension fund liabilities to the concurrent recognition and financing of pension fund liabilities. On the lengthy deferral end of the continuum of funding methods, if the policy maker chooses not to finance pension benefit liabilities until the payment of those liabilities become due and default of the public pension fund is imminent, the policy maker has chosen the current disbursement (or "pay-as-you-go") funding method. On the concurrent end of the continuum of funding methods, if the policy maker chooses to amass assets as reserves for the accruing public pension fund liabilities as service is rendered, the policy maker has chosen a full actuarial funding method.

Implementation of the current disbursements funding method and adoption of a non-funding philosophy does not reduce the actual aggregate cost of paying retirement benefits, but merely shifts the timing of the financing and the sources of the financing. Substantially increased benefit costs which are deferred but which become fully payable from tax revenues are traded for a reduction in the need for immediate financing.

Under a non-funding philosophy, when there are few benefits recipients, the cost of the pension plan is small, but will grow immensely as the number of benefit recipients increases.

With respect to the consequence of the allocation of the burden of financing the liability between available financing sources, the current disbursements funding method eliminates some financing sources and makes a fair distribution between the remaining financing sources difficult. If the current disbursements funding method is utilized, then no sizeable amount of assets is accumulated by the pension fund and no substantial investment income is earned. Without investment income as a financing source, the burden of financing must be allocated between the remaining sources.

The choice of a funding method on the continuum beyond the current disbursements (or "pay-as-you-go") funding method represents the choice of a full actuarial funding method of some type. Although federal legislation does not require full actuarial funding for public employee pension funds as it does for private sector employee pension funds, the Commission considers the following to be compelling reasons for adopting a full actuarial funding philosophy for public employee pension funds:

(1) Sound financing of retirement benefits requires that the current cost, or present value, of the retirement benefit accruing to each pension fund member be recognized as a current debt and be paid for contemporaneously as the pension credit on which the retirement benefit is based is being earned. Following this

practice insures that the actual cost of retirement benefits for present active members attributable to a year of service to the taxpayers will be borne by those same taxpayers and will not become a liability which is deferred to a future generation of taxpayers.

(2) Full funding on current financing basis guarantees that the full cost of the components of employment compensation, salaries and other benefits, will be recognized, thereby enforcing fiscal responsibility and discipline in providing both salary and pension increases.

(3) The assets of the pension fund which result from the amassing of actuarial reserves on a current financing basis are invested and will earn investment income. As the third major source of financing along with member and employer contributions, investment earnings will reduce potential annual dollar outlay required from tax reserves when compared to a current disbursements (or pay-as-you-go) financing basis.

(4) The accumulation of fully funded actuarial reserves assures benefit security for both present and future pension benefit recipients, since the pension fund will have the means to pay pension benefits over any short term shrinkage of available governmental financial resources and even upon the potential default or bankruptcy of the governmental entity.

There are a number of consequences which may result from the failure to implement a full actuarial funding method and which the Commission views as undesirable. These consequences are as follows:

(1) A failure to implement a full actuarial funding method will result in the shifting, or deferment, of the ultimate burden of financing public employee pensions from this generation of taxpayers. The real cost of providing compensation and other benefits for this group of public employees will not be currently or fully recognized consequently. It is unlikely that the financing necessary to pay for public employee pensions will be any easier to obtain in the future than it is currently. Any failure to implement full actuarial funding is equivalent to a governmental unit committing the resources of the entity beyond the current budget year, which is generally viewed to be inappropriate.

(2) A failure to implement a full actuarial funding method will mean the loss of potential investment income which could otherwise be earned. Any loss of potential investment income, one of the three sources of financing for a pension fund (investment income, member contributions and employer contributions), will require additional contributions from either the member, or the employer, or both. Additional employer contributions will require either the raising of additional tax revenues or the reduction of other governmental services to balance the cost.

(3) A failure to implement a full actuarial funding method will risk the loss of the current bond rating of the sponsoring employer. Government bond analysts are more and more concerned about the size of unfunded accrued liabilities of public employee pension funds when considering the financial condition of units of government. The State of Massachusetts and the City of Boston reportedly suffered a loss in their bond ratings when the substantial underfunding of public retirement funds in that state were disclosed. Once the confidence of investors in a governmental unit's financial affairs is shaken, the task of restoring that confidence will be very onerous. If poor retirement financing is the cause of the loss of the bond rating, only substantial improvements in both the financing and the funded condition of the retirement fund over a very short period of time will provide a basis for restoring the bond rating. If bond ratings suffer because of a lack of retirement financing, the cost of all capital improvement projects will increase.

(4) A failure to implement a full actuarial funding method carries with it the potential for an eventual default by the public employee pension fund involved. Any potential default will be speeded by a significant maturing of the employee group covered by the public employee pension fund or by benefit improvements.

(5) A failure to implement a full actuarial funding method runs the risk of defrauding the members of the public employee pension fund who expect a certain level of benefits and who may not be

able to receive them. The chief difference between unfunded accrued liabilities of retirement funds and other types of governmental debt is that these pension debts are owed to a large ill-defined group of people who are unable or unlikely to pursue legal remedies to insure payment. In any other area, if the governmental unit committed to pay specified amounts, and thereby incurred a liability, it would be unthinkable that the governmental unit would fail to pay the liability. In the area of pension liabilities, the same principles should not be disregarded simply because a broad, diffuse group of current and future retirees is involved. It theoretically can be, and may actually in the future be, successfully argued that to promise pension benefits, thereby inducing employees to rely on those promises in their employment and retirement income planning, without the intent to actually finance the liability and pay the retirement benefits constitutes fraud by the sponsoring unit of government.

(6) Finally, the failure to implement a full actuarial funding method may constitute a breach of fiduciary duty by parties responsible for the administration of the public employee pension fund, subjecting them to personal liability for their actions. In general, any person who has discretionary control over the benefits provided by, the financing provided to, the investment of the assets of, or the management and operation of a retirement fund is a fiduciary. A fiduciary owes a duty to the participants and benefit recipients of a retirement plan to perform his

discretionary acts in good faith and solely in the best interest of those participants and benefit recipients. Failure to meet this duty constitutes fiduciary breach, which is actionable and can subject the fiduciary to personal liability.

The adoption of a full actuarial funding goal is consistent with the mandate of Act 66 of 1981, the Commission's organizing law, which specified that the Commission was to develop and recommend legislation which would mandate "actuarial funding standards," and is consistent with the required practice in private sector pension funds pursuant to the federal Employee Retirement Income Security Act of 1974 and the growing practice in public sector pension funds following recommendations by the National Governor's Association, the National Conference of State Legislatures and the Municipal Finance Officers Association.

RECOMMENDATION: The Commission recommends adoption of a full actuarial funding goal, using an actuarial valuation method under which pension plan liabilities are, to the extent possible, recognized concurrently or coincidentally with the rendering of the service by pension plan participants from which they arise and requiring that sufficient financing be provided to the pension plan to match the pension plan liabilities as they are recognized.

FUNDING GOALS

The Commission took notice that there is a range of alternative funding goals which may be selected depending on the short term and long term cost incidence pattern which is desired. On one end of the continuum, the goal is reduced immediate and near term costs during the early years of the establishment of a pension plan, with increasing costs over time.

On the other end of the continuum, the goal is both a short and a long term cost incidence pattern which is level as either a percentage of covered payroll or as a dollar amount.

The Commission decided that the current disbursements (or "pay-as-you-go") funding method, with the short term advantage of a reduced early cost incidence pattern balanced against the long term disadvantage of an almost perpetually increasing long term cost incidence pattern, was inappropriate. It decided that a full actuarial cost method, which offers the long term advantage of a level percentage of payroll or dollar amount cost in exchange for the short term disadvantage of a cost incidence pattern which is greater than the cost incidence pattern generated by the current disbursements method, is more appropriate.

The Commission considered the various actuarial valuation methods. Actuaries have developed a number of different actuarial valuation methods for use in estimating at any point in time the pension liability currently being undertaken, and the pension liability already undertaken, by a pension plan. These actuarial valuation methods were generally developed by actuaries using a model pension fund population, with an absolutely even distribution of age, salary and service, so that each participant who gained an additional year of age and service and an additional increment of salary was replaced by another participant who in turn was replaced by still another participant, and so forth. A participant retiring at the upper end of the age, salary and service ladder would be replaced by a newly hired participant. The actuarial valuation methods were developed to provide plan sponsors with some alternative funding methods, providing small changes in the cost incidence pattern while still recognizing concurrently all or substantially all of the pension fund liability associated with the crediting of additional service.

With most of the various actuarial valuation methods, which were developed using a model pension fund population, a vast difference in the group of plan participants from the model group could produce a considerable variation in the expected cost pattern. The entry age normal actuarial cost method is the only actuarial valuation method which, by design, will produce a level funding requirement over time irrespective of varying pension plan demographics.

The Commission is required to make recommendations concerning actuarial funding standards for all municipal systems in the Commonwealth. The actuarial valuation method can also serve as the actuarial funding standard by requiring the plan sponsor or employer to pay any portion of the financing determined under the actuarial valuation method which is not paid from some other source (like member contributions). As an actuarial funding standard, an actuarial valuation method measures the short and long term cost of a pension plan for the purpose of specifying the amount of required financing of a pension fund, especially employer contributions. In selecting an actuarial valuation method for use by municipal pension plans in the Commonwealth, the Commission considered the following additional functions which an actuarial valuation method may serve:

(1) An actuarial valuation method which is standardized or uniform provides comparability of data over time and between pension

plans and can be used to measure the relative financial health or distress of a pension plan, both individually and when compared with other pension plans.

(2) An actuarial valuation method which does not understate the current impact by deferring the cost incidence into the future serves to measure the impact on the funded condition and required financing of a pension plan when benefit increases to active or retired members are considered.

(3) An actuarial valuation method which accurately reflects both current and long term costs, which produces results which are reasonably stable and consistent over time and which does not understate the current cost incidence and defer the cost incidence into the future can function to measure the short term and long term ongoing cost of the pension plan for the purpose of determining the proper allocation of required pension fund financing between the member contributions, if any, the employer contributions and any other source of financing for the pension plan.

(4) An actuarial valuation method which is generally accepted for public pension plans can be used to measure pension fund liabilities and financing requirements for various external reporting purposes, such as the annual financial statement of the governmental unit.

Specification of a standardized or uniform actuarial valuation method will be useful in the future work of the Commission in monitoring the funding and financing aspects of municipal pension plans in the Commonwealth and will be essential in determining which municipal pension plans in the Commonwealth are financially distressed and as such should participate in the municipal pension plan recovery program. The Commission concluded that specification of the entry age normal actuarial cost method for use as the funding standard for municipal pension plans in the Commonwealth is the most certain way of ensuring that the pension plan cost incidence patterns for the various municipal pension plans in the Commonwealth will be a level percentage of covered payroll. The level percentage of covered payroll cost incidence pattern is, in the view of the Commission, the most appropriate pattern for a benefit of employment in the Commonwealth which is generally related to salary. It also emphasizes fiscal discipline in the pension plan over time and spreads an equal financing burden over various generations of taxpayers. It is most likely to provide reliable and meaningful estimates of the cost impact of proposed benefit increases and is the best suited to the rational determination of the proper member contribution rate in contributory pension plans.

RECOMMENDATION: The Commission recommends adoption of a funding method which produces both a short term and a long term cost incidence pattern for this benefit of employment which is level as a percentage of covered payroll.

RECOMMENDATION: The Commission recommends adoption of an actuarial valuation method which is uniform and standard for all municipal pension plans in the Commonwealth which are self-insured either in whole or in part unless compelling reasons on an individual basis can be demonstrated by a particular municipal pension fund, pursuant to rules and regulations adopted by the Commission, that an alternative actuarial valuation method should be used, and that the actuarial valuation method be the entry age normal actuarial cost method, with the entry age established as the actual entry age for all plan members.

APPLICATION OF PROPOSED FUNDING STANDARD

On the basis of plan design, municipal pension plans in the Commonwealth can be divided into two broad types, the defined contribution plans and the defined benefit plans. In a defined contribution plan, the financing of the public pension plan is fixed as a set dollar amount or percentage of pay and the amount of the eventual pension benefit is variable, dependent chiefly on the amount of financing. In a defined benefit plan, the amount of the eventual pension benefit is fixed as a set dollar amount or percentage of covered salary for some period of service (range of final salary to career average salary), and the financing of the plan is variable, dependent on the actuarial funding method chosen.

Within each broad type of pension plan, the various municipal plans in the Commonwealth can be distinguished on the basis of the source of the guarantee of the payment of the eventual pension benefit. The division is as follows:

Defined Contribution Plans	Defined Benefit Plans
1. Fully insured by an authorized insurance carrier.	1. Fully insured by an authorized insurance carrier.
2. Partially insured by an authorized insurance carrier and partially self-insured.	2. Partially insured by an authorized insurance carrier and partially self-insured.
3. Totally self-insured.	3. Totally self-insured.

The Commission considers the application of actuarial funding standards to be most appropriate for defined benefit plans which are partially insured by an authorized insurance carrier and partially self-insured or defined benefit plans which are totally self-insured. For defined contribution or defined benefit plans which are fully insured by an authorized insurance carrier, there is little need for the application of the same funding standard developed for pension plans which are not fully insured because the current laws of the Commonwealth governing insurance carriers which are authorized to do business in the Commonwealth require the accumulation of reserves in relation to the liabilities undertaken by the insurance carriers.

For defined contribution plans which are either partially insured by an authorized insurance carrier and partially self-insured or totally self-insured, the Commission sees only a limited need for a rigorous funding standard because there is little potential for incurring pension plan liability beyond the financing provided. For these two types of defined contribution plans, if both the employer and the member make the contribution required by the plan and do not submit promissory notes or the equivalent, the pension plan can only incur an unfunded accrued liability if the actuarial assumptions on post retirement mortality or post retirement investment income are not set appropriately in relation to the experience of the pension plan.

RECOMMENDATION: The Commission recommends that a differentiation be made in the application of the funding standard between defined contribution and defined benefit plans and between plans which are fully insured by an authorized insurance carrier and plans which are self-insured in whole or in part. The funding standard would differentiate between the various types of pension plans as follows:

Type of Plan	Application of Funding Standard
Defined Benefit Plan - Self-Insured	Full application of funding standard recommended by Commission.
Defined Benefit Plan - Partially Insured By An Authorized Insurance Carrier	Full application of funding standard recommended by Commission.
Defined Benefit Plan - Fully Insured By An Authorized Insurance Carrier	Exception from funding standard recommended by Commission in favor of Commonwealth insurance laws and regulations.
Defined Contribution Plan - Totally Self-Insured	Application of funding standard recommended by Commission limited to requirement that contributions be made as required by the plan and that actuarial assumptions be verified by periodic experience study.
Defined Contribution Plan - Partially Insured By An Authorized Insurance Carrier	Application of funding standard recommended by Commission limited to requirement that contributions be made as required by the plan and that actuarial assumptions be verified by periodic experience study.
Defined Contribution Plan - Fully Insured By An Authorized Insurance Carrier	Exception from funding standard recommended by Commission in favor of Commonwealth insurance laws and regulations.

ACTUARIAL IMPLEMENTATION QUESTIONS

From an actuarial standpoint, the Commission considered a number of questions related to the adoption of a funding standard beyond the requirement of the use of an actuarial valuation method and the specification of a particular actuarial valuation method.

Determination of Actuarial Assumptions

The actuarial assumptions used in the valuation of a pension plan can have a substantial impact on the determination of the financing required for a pension plan and the extent of the recognition of pension liability by a pension plan. Consequently, in establishing a funding standard for municipal pension systems of the Commonwealth, the Commission gave consideration to appropriate actuarial assumptions.

A distinction is frequently drawn between different broad types of actuarial assumptions. The distinction is between economic assumptions and demographic assumptions. Economic assumptions are those variables in the calculation of projected pension benefits which are a function of those forces, chiefly economic, which apply to society broadly and are beyond the narrow confines of the group of participants and benefit recipients involved in the pension plan. Demographic assumptions are those variables in the calculation of projected pension benefits which are a function of those forces which apply specifically to the group of pension plan participants and benefit recipients involved in the pension plan.

The following sets forth the main economic and demographic actuarial assumptions which may be involved with a pension plan:

Economic Assumptions	Demographic Assumptions
Investment Income (Interest)	Withdrawal of Active Members
Salary Increase - Merit or Longevity	Pre-retirement Disability
	Pre-retirement Mortality

Economic Assumptions (Continued)	Demographic Assumptions (Continued)
Cost of Living Increases - Salary or Post Retirement Adjustments	Retirement Age
	Post Retirement Mortality
	Post Disablement Mortality
Social Security Benefits	

Actuarial assumptions are used as the basis for projecting the future retirement benefits payable from a pension plan. From those projections, the funded condition and financing requirements for the pension fund under an actuarial valuation method are derived. If those projections are not accurate, then the resulting determinations of the funded condition and financing requirements of the pension fund also will not be accurate and eventual unfunded accrued liability in the pension plan will be created for this reason. Consequently, the Commission believes that each actuarial assumption should reflect the best estimate which can be made of future expected experience. The procedure for setting actuarial assumptions independently based on the best estimate of future experience is frequently referred to as setting "explicit" actuarial assumptions. The procedure for setting actuarial assumptions in a balancing tandem or package is frequently referred to as setting "implicit" actuarial assumptions. While actuarial assumptions can be set in tandem, with optimistic assumptions balanced by pessimistic assumptions, and the result roughly reflecting the expected experience, the Commission does not view this as the appropriate procedure for establishing actuarial assumptions.

Actuarial assumptions are inherently long term assumptions. They are used to project the amount of pension benefits expected to be paid far into the future and to calculate the present value of those eventual benefits. When set or reset, they have application both as a measure of the future experience of the pension plan and as a measure of the past experience of the pension plan. When setting actuarial assumptions, care must be exercised to distinguish the start of long term trends, which should be reflected in the actuarial assumptions, from short term observations, which should not be reflected in the actuarial assumptions. For instance, if the current high rates of interest are the start of a long term trend which will last for a considerable portion of the expected lifetime of current active participants, then the actuarial assumption on investment income or interest ought to be set at a rate close to the current market rates. If however, the current high rates of interest are not indicative of a long term trend and reflect only a short term anomaly, then the actuarial assumption on investment income or interest ought to be set at a lower rate than the current market rates.

While actuarial assumptions are to reflect the long range expectations for the experience of the pension plan, they do require periodic examination and revision in the event of changing circumstances. To assist in the actuarial assumption revision process, the Commission endorses the practice, where appropriate, of having the actuarial valuation of a pension plan contain an analysis by the actuary of the causes of any increase or decrease in the unfunded accrued liability of the plan, especially actuarial experience gains and losses, and considers the periodic preparation of an experience study, comparing the actual experience of the pension plan with the experience expected pursuant to the significant actuarial assumptions of the pension plans for a number of years, to be beneficial.

RECOMMENDATION: The Commission recommends that best estimate explicit economic and demographic actuarial assumptions be used in preparing any required actuarial valuations. The best estimate explicit actuarial assumptions shall be determined by the board of trustees of and the actuary retained by each municipal pension plan, with specification by the Commission of a narrow range of economic actuarial assumptions which could be utilized without the provision of additional documentation, but in the event of economic actuarial assumptions not contained within the specified narrow range, the economic assumptions could be utilized if an explanation and justification for the assumptions chosen is provided.

RECOMMENDATION: The Commission recommends that each actuarial valuation report provide an analysis of the increase or decrease in the unfunded accrued liability of the pension plan, including an indication of increases or decreases due to modifications in the benefit plan, changes in actuarial assumptions, deviations in actual experience from the assumed experience, payments to amortize the unfunded accrued liability of the pension plan or other reasons, or provide an explanation and justification of the appropriateness of the omission of this analysis.

RECOMMENDATION: The Commission recommends that periodically an experience investigation of the pension plan be conducted to compare the actual experience of the plan with the experience expected pursuant to those actuarial assumptions which significantly affect the results of the actuarial valuations of the pension plan.

Amortization of Unfunded Accrued Liabilities

It is a common occurrence in most defined benefit pension plans that an unfunded accrued liability will exist. An unfunded accrued liability will occur when the accumulated assets of the pension fund are less than the accrued liability of the pension plan at that point in time as calculated by the actuary. This unfunded accrued liability is really an indication that past contributions from all financing sources were less in prior years than the pension benefit liability which ultimately was recognized in those years. This difference in the liability which ultimately was recognized and the actual contributions which actually have been made can occur for one or more of the following reasons:

(1) because of the recognition of past service rendered prior to the establishment of the pension plan;

(2) because contributions in an amount less than the estimated or eventual normal cost rate were made;

(3) because pension benefits were increased;

(4) because the actuarial valuation method used to determine the funded condition and financing requirements of the pension plan was changed; or

(5) because some element of experience deviates unfavorably from the assumption used by the actuary.

In endorsing the use of a full actuarial funding method to recognize and finance pension benefit liabilities systematically, the Commission recommends that any unfunded accrued liability be amortized over a reasonable period of time. If a pension plan has an unfunded accrued liability, this means that the pension plan recognizes more pension liability than it has amassed assets to cover. Since most full actuarial funding methods involve discounting the total pension benefit liability by the amount of assumed investment income on accumulated pension fund assets, interest equal to the amount of assumed investment income on the amount of unfunded accrued liability must be included as a financing requirement to avoid an increase in the unfunded accrued liability solely by virtue of lost investment income on those omitted assets. The unfunded accrued liability is no different from any other debt which has been recognized and must be paid. As the first step in paying this actuarial deficit, the financing from some source or combination of sources must be increased to cover the assumed interest on the amount of the deficit or debt. If interest at the assumed rate is paid every year, then the amount of the unfunded accrued liability will remain constant as a dollar amount.

In selecting a funding standard which requires the payment of normal cost and amortization of the unfunded accrued liability, the Commission considered the appropriate amortization period or periods. The two chief factors in determining the appropriate amortization period or periods are the length of the period and extent of flexibility needed to revise the period in the event of an increase in the amount of the unfunded accrued liability. The length of the amortization period will directly affect the amount of financing required to amortize the unfunded accrued liability. The longer the amortization period selected is, the smaller the required amortization contribution will be. In the future, the unfunded accrued liability can increase. The increase can occur for a number of reasons, such as the enactment of a benefit increase, a strengthening of one or more actuarial assumptions or the occurrence of an experience loss. As a consequence, the Commission considers a procedure to revise the amortization period to be desirable.

RECOMMENDATION: The Commission recommends that, for purposes of determining unfunded accrued liability and other related purposes, assets be valued to accommodate asset mix and reduce the impact of market fluctuations in accordance with rules and regulations adopted by the Commission.

RECOMMENDATION: The Commission recommends that, for each municipal pension plan with a defined benefit plan, the funding standard require the payment in addition to normal cost of an amount sufficient to amortize any unfunded accrued liability on a level annual dollar basis with the following amortization periods:

	Type of Unfunded Accrued Liability	Amortization Period
a.	Unfunded accrued liability existing on the date of enactment.	30 years
b.	Unfunded accrued liability attributable to a change in actuarial assumptions	20 years
c.	Unfunded accrued liability attributable to modifications in the benefit plan (benefit increases) for active members	20 years
d.	Unfunded accrued liability attributable to post retirement adjustments granted to retired members and other benefit recipients	10 years
e.	Unfunded accrued liability attributable to net experience losses	15 years

Application of the Funding Standard to Component Parts of the Benefit Plan

The benefit plan of any pension plan is composed of a number of component parts. Among municipal pension plans in the Commonwealth, it is common to have the following component parts to a benefit plan:

(1) a retirement annuity;

(2) a disability benefit;

(3) a survivor benefit;

(4) a vested (deferred retirement annuity) benefit;

(5) a refund of member contributions benefit; and

(6) a post retirement increase benefit.

In the view of the Commission, use of different actuarial valuation methods for components of the benefit plan beyond the retirement annuity would complicate the application of a funding standard which is based on the selection of a particular uniform actuarial valuation method. The Commission has concluded that the application of the actuarial valuation method used as the basis for the funding standard to all component parts of the benefit plan will insure uniformity, comparability and reliability in preparation of actuarial reports of the various municipal pension plans.

RECOMMENDATION: The Commission recommends that the actuarial valuation method used as the basis for the funding standard be applicable to all of the component parts of the benefit plan.

Frequency of Actuarial Valuations

Currently, Act 293 of 1972, the law administered by the Commission which requires actuarial reporting by the more than 2,000 municipal pension plans in the Commonwealth, requires actuarial reporting by municipal pension plans with fewer than 50 members (active or retired) on a quadrennial basis and actuarial reporting by municipal pension plans with 50 or more members on a biennial basis.

With the development of an actuarial funding standard which relies heavily on actuarial reporting, the Commission reviewed the appropriate frequency of the preparation of actuarial valuation. The Commission considered four years to be a very long period to elapse between actuarial valuations and noted that actuarial valuations which occur more frequently than every four years have the following advantages:

(1) providing regular confirmations of the ongoing costs of the pension plan;

(2) reflecting any increases in the unfunded accrued liability which may occur into the financing requirements of the pension plan more quickly; and

(3) allowing for more frequent monitoring of experience losses and the adequacy of various actuarial assumptions.

RECOMMENDATION: The Commission recommends that actuarial valuation for all defined benefit plans which are self-insured in whole or in part be required on a biennial basis if the municipality has not previously applied and is not applying for supplemental state assistance provided in the recovery program, or on an annual basis if the municipality has previously applied or is applying for supplemental state assistance provided in the recovery program.

RECOMMENDATION: The Commission recommends that the cost of actuarial valuations be an allowable administrative expense payable from the assets of the pension plan.

Entity Responsible for Adherence to Funding Standard

With the imposition of a funding standard on municipal pension systems, the Commission considered the appropriate governmental entity to be held responsible for adherence to the funding standard. In the current development of the common law on public employee pensions in the Commonwealth, a public employee pension is generally viewed as a contractual relationship between the public employee and the public employer. Whether the contract is a bilateral contract or a unilateral contract, the public employer is viewed as having promised the payment of the public pension to the public employee. As a consequence of this common law development, the Commission concluded that the public employer, which in this case is the municipality, should be held responsible for adherence to the recommended funding standard.

RECOMMENDATION: The Commission recommends that the municipality which established and maintains the pension plan be responsible for making any portion of the required funding standard contribution which is not made by member contributions or any applicable state casualty or fire insurance revenues.

Penalty for Deviation from Funding Standard

With the establishment of a municipal pension plan funding standard, the issue of the appropriate penalty for deviation from the funding standard was examined by the Commission. The goal of any municipal pension plan funding standing is to ensure that the appropriate amount of financing is provided to the municipal pension plan. Since that is the case, the Commission believes that any penalty should be designed to assist the financing of the plan rather than to reduce it. The Commission determined that, in addition to the imposition of a legal mandate to comply with the funding standard, the requirement that any deviation be reported to the Governor, General Assembly and other interested parties is an appropriate initial remedy unless and until the need for a more severe penalty to ensure compliance is demonstrated.

RECOMMENDATION: The Commission recommends that, initially, the penalty for failure to comply with the legal requirements of the municipal pension plan funding standard be the reporting of that failure to comply to the Governor, General Assembly and other interested parties.

State Agency Charged with Enforcement of Funding Standard

With the adoption of a municipal pension plan funding standard and the imposition of a penalty for a deviation from the funding standard, the Commission considered the appropriate state agency to be charged with the enforcement of the funding standard. Because the data needed for determining compliance with the funding standard is maintained by the Public Employee Retirement Study Commission, it would be appropriate to assign the Commission with the task of monitoring compliance.

RECOMMENDATION: The Commission recommends that the state agency charged with monitoring compliance with the municipal pension plan funding standard be the Public Employee Retirement Study Commission, through use of the Act 293 of 1972 actuarial reporting mechanism.

PART II

DETERMINATION OF MUNICIPAL PENSION SYSTEMS WHICH ARE FINANCIALLY DISTRESSED

In addition to the formulation of legislation mandating actuarial funding standards for all municipal pension systems, Act 66 of 1981 directed the Commission to formulate legislation establishing a "recovery program for municipal pension systems determined to be financially distressed." Accordingly, the Commission addressed the appropriate definition of municipal pension systems as well as what constitutes financial distress in a municipal pension system. The criteria to be evaluated in the determination and the entity to be charged with making the determination were also examined by the Commission in formulating legislation to establish a recovery program for financially distressed municipal pension systems.

DEFINITION OF MUNICIPAL PENSION SYSTEM

In specifying the requirement for the Commission to develop a program for the recovery from the situation of financial distress, Act 66 of 1981 refers to municipal pension systems. The definition of a municipal pension system will govern which pension plans in the Commonwealth are to be included in the determination of financial distress and in the remedies from financial distress contained in a recovery program.

The Commission is aware that there are many alternative approaches to the definition of municipal pension system. Many municipalities have established and maintain more than one pension plan (and trust fund) for their public employees. These can include three plans: a police pension plan, a paid firefighter pension plan and a non-uniformed (general, non-public safety) employee pension plan. In addition, municipalities have the power to create municipal authorities which can be operating authorities employing public employees and having separate pension plans. Also, municipalities can engage in a joint enterprise with other municipalities, such as a Council of Governments or a regional governmental enterprise pursuant to Act 180 of 1972, the Intergovernmental Cooperation Act, and these joint enterprises can employ public employees and have separate pension plans. For purposes of Act 293 of 1972, the current municipal pension plan actuarial reporting law, municipal authorities, Councils of Governments and Intergovernmental Cooperation Act enterprises are considered to be separate municipalities and file separate actuarial reports for their pension plans. The appropriate definition of a municipal pension system for the determination of financial distress could be that of each individual public employee pension plan in a municipality or that of each municipality which has one or more public employee pension plans.

The Commission concluded that the consideration of the municipality as a whole and the various municipal pension plans in aggregate as the municipal pension system fully recognizes the fact that the ultimate liability for every pension plan in a municipality rests with that municipality. It also avoids potential distortions in the determination process caused by the situation where funding by a municipality in excess of the actuarial requirement occurs in the case of one municipal pension plan while nominal funding by the municipality occurs in the case of another municipal pension plan. In addition, it simplifies the task of making the determinations of financial distress. There are currently somewhat in excess of 2,000 municipal pension plans in the Commonwealth, but there is the potential for several times that number among the approximately 5,000 municipalities in existence in the Commonwealth. With the determination of financial distress based on both actuarial considerations and municipal finance considerations, aggregate consideration is very appropriate.

RECOMMENDATION: The Commission recommends that in determining whether or not a municipal pension system is financially distressed, the appropriate definition of a municipal pension system is the municipality as a whole, considering its various pension plans in aggregate.

RECOMMENDATION: The Commission recommends that for purposes of the municipal pension system financial distress determination, municipal authorities, Councils of Governments and regional governmental entities created pursuant to the Intergovernmental Cooperation Act should be considered to be municipalities separate from any other municipalities with which they may be associated.

DEFINITION OF FINANCIAL DISTRESS IN A MUNICIPAL PENSION SYSTEM

Act 66 of 1981 requires the Commission to develop a program for the recovery of municipal pension systems which are financially distressed. Inclusion in the remedies from financial distress which are contained in a recovery program depends on the definition of financial distress in a municipal pension system and the procedure for determining whether the elements of the definition have been met.

Broadly, financial distress means the condition of being subject to great fiscal strain or having great difficulties in gaining access to necessary monetary support. For a municipal pension system, the term focuses on a particular actual or potential liability, that being the obligation to pay for pension benefits accruing or payable.

The determination of whether or not a municipal pension system is financially distressed and the degree of that financial distress can be made either in a highly structured, mechanical and quantifiable manner or in a more loosely structured, less mechanical and less quantifiable manner. In the highly structured determination procedure, certain key indicators of financial distress can be identified, ranked or scored on a common basis and the decision on whether or not the municipal pension system is financially distressed and the degree of that financial distress made by virtue of this ranking or scoring. The Commission viewed the highly structured procedure as having the advantage of being relatively speedy, relatively simple to administer, generally stable and predictable in its results and less likely to have its results challenged by disgruntled participants.

In a highly structured determination procedure, financial distress for a municipal pension system can be solely related to actuarial considerations, solely related to municipal finance considerations or related to both actuarial and municipal finance considerations. Actuarial considerations measure financial distress for a municipal pension system based on the relative magnitude of the cost of the pension plan or its past departure from sound funding practices. Municipal finance considerations measure financial distress for a municipal pension system based on the relative magnitude of the ability of the municipality to raise revenue. The combined actuarial and municipal finance considerations measure financial distress for a municipal pension system based on both the relative magnitudes of the cost of the municipal pension system and the ability of the municipality to raise revenue and the relationship between the two.

The Commission concluded that both the pension financing need and the municipal capacity to meet that need should be considered in the financial distress determination, since a problem in either of these two broad areas can result in a situation of financial distress. While the existence of a huge pension obligation and a severely diminished capacity to generate additional revenue clearly indicates a situation of financial distress, financial distress also occurs in a municipality where the pension obligation is more modest but the capacity to generate additional revenue is nonexistent and in a municipality where the capacity to generate additional revenue is present to a modest degree but the pension obligation is huge.

In determining the appropriate weighting to be given to the two broad measures of financial distress, the Commission considered the tandem effect of the need, evidenced by the actuarial considerations, and the capacity to meet the need, evidenced by the municipal finance considerations. Weighting the broad actuarial considerations equally with the broad municipal finance considerations reflects this tandem effect.

RECOMMENDATION: The Commission recommends that the procedure for the determination of whether or not a municipal pension system is financially distressed and the degree of that financial distress should be made in a highly structured, mechanical and quantifiable manner.

RECOMMENDATION: The Commission recommends that the financial distress determination procedure should take into account both actuarial considerations, the actuarial condition of the aggregated pension systems of the municipality, and municipal finance considerations, the ability of the municipality to raise the necessary revenue for this purpose.

RECOMMENDATION: The Commission recommends that the actuarial considerations component and the municipal finance considerations component in the financial distress determination procedure should each be given equal weighting in making the determination of whether or not a municipal pension system is financially distressed and the extent of that distress.

From an actuarial standpoint, financial distress for a municipal pension system can be measured using three broad areas of actuarial concern, the imminence of default (inability of accumulated reserves and available financing to meet the amount of pension benefits payable), the past departure from sound funding principles and the existence of substantial future costs attributable to the requirements of the benefit plan in force. The Commission has developed a series of actuarial indicators to measure these broad areas of concern and has scaled each of the measures to reflect the degree of departure from the situation of a soundly funded pension plan.

The comparison of accumulated reserves with current disbursements (pay-as-you-go) funding requirement measures the ability of the fund to sustain the liability immediately payable. The comparison of the overall liability undertaken by the pension plan with accumulated reserves measures the ability of the fund to handle the liability ultimately payable. Together, they measure the margin over the immediate payment requirements of the pension plan and the relationship that margin bears to the broader liability of the plan. A well funded pension plan should have a considerable margin of accumulated reserves over the current disbursements requirement and should have a substantial portion of the ultimate liability of the pension plan in reserve.

The size of the cost of the current total benefit plan to the employer measures the cost of the benefit plan offered to employees in that municipality, in aggregate, inclusive of Social Security. The cost of the benefit plan, for the non-Social Security portion, is a function of the amount of benefits provided to eligible employees, the eligibility for and access to these benefits and the demographics of the employee group covered. The comparison of the obligation to fund the current unfunded accrued liability of the plan with the normal cost of the plan relates the magnitude of effort required to recover from past funding insufficiencies to the ongoing cost of the pension plan. Together, they measure the ongoing funding pressure on the municipality from the rendering of future service by current employees and the existence of unfunded past service liabilities attributable to current retirees and active employees. A well funded pension plan will typically have a modest, or moderate, sized cost of the current total benefit plan to the employer because of the provision of adequate, but not overly generous, benefits and the requirement of employee financing for a substantial portion of the normal cost of the benefit plan. The cost of retiring unfunded past service liabilities of a well funded pension plan will be less than the normal cost of the benefit plan.

The comparison of current contributions with the full amortization financing requirement measures the departure from adherence to the recommended actuarial funding standard in the most recent year. The comparison of the growth of the unfunded accrued liability over time with the growth of municipal contributions to the plan over time measures past municipal response to a worsening funding situation. Together, they measure the past and current deviation from the recommended funding standard. A well funded pension plan will be in the position where the recommended funding standard will be met or exceeded, and will have employer contributions increasing at the same or a faster pace than the unfunded accrued liability of the plan.

RECOMMENDATION: The Commission recommends that the actuarial considerations in the financial distress determination procedure should measure the actuarial component of financial distress broadly, with a long term orientation, on the basis of the imminence of default, the past departure from sound funding principles and the existence of substantial future costs attributable to the requirements of the benefit plan in force. Specifically, the actuarial indicators and the scoring or ranking attributable to each should be as follows:

a. Comparison of accumulated reserves with current disbursements (pay-as-you-go) funding requirement (current annuities and retirement benefits payable as a percentage of current plan assets).

Percentage	Scoring or Ranking
0 - 5%	0
6 -10%	10
11-15%	20
16-20%	30
21-30%	40
31-40%	50
41-50%	60
51-60%	70
61-70%	80
71-80%	90
81% or greater	100

b. Comparison of the overall liability undertaken by the pension plan with accumulated reserves (current plan assets as a percentage of the accrued liability of the plan).

Percentage	Scoring or Ranking
50% or greater	0
40 - 49%	10
30 - 39%	20
25 - 29%	30
20 - 24%	40
15 - 19%	50
10 - 14%	60
7.5- 9%	70
5.0-7.4%	80
2.5-4.9%	90
0-2.4%	100

c. Size of the cost of the current total benefit plan to the employer (normal cost of the plan less the rate of any member contributions plus the rate of any employer Social Security contributions on total covered payroll, all expressed as a percentage of covered payroll).

Size (as percentage of payroll)	Scoring or Ranking
0- 9.99%	0
10.00-11.99%	10
12.00-12.99%	20
13.00-13.99%	30
14.00-14.99%	40
15.00-15.99%	50
16.00-16.99%	60
17.00-17.99%	70
18.00-18.99%	80
19.00-19.99%	90
20.00% or greater	100

d. Comparison of the obligation to fund the current unfunded accrued liability of the plan with the normal cost of the plan (result of dividing the requirement to amortize the unfunded accrued liability of the plan on a level basis over the amortization period expressed as a percentage of payroll by the normal cost of the plan expressed as a percentage of payroll).

Result	Scoring or Ranking
0-0.39	0
0.40-0.79	10
0.80-1.19	20
1.20-1.39	30
1.40-1.59	40
1.60-1.79	50
1.80-1.99	60
2.00-2.19	70
2.20-2.39	80
2.40-2.59	90
2.60 or over	100

e. Comparison of current regular contributions with the full amortization requirement (difference between normal cost plus the amount required to amortize on a level basis the unfunded accrued liability over the specified period and the total member contributions, municipal contributions and amounts received from the foreign casualty insurance premium tax state aid program, the paid firefighters foreign fire insurance premium tax state aid program or the general municipal pension system state aid program, whatever is applicable, received by the plan for the previous year, all expressed as a percentage of payroll).

Difference (as percentage of payroll)	Scoring or Ranking
0- 2.4%	0
2.5- 4.9%	10
5- 9.9%	20
10-14.9%	30
15-19.9%	40
20-24.9%	50
25-29.9%	60
30-34.9%	70
35-39.9%	80
40-44.9%	90
45% or over	100

f. Comparison of the growth of the unfunded accrued liability over time with the growth of municipal contributions to the plan over time (relationship between the compound percentage rate of increase representing the increase in the unfunded accrued liability from a prior year to the most recent year and the compound percentage rate of increase representing the increase in municipal contributions to the plan from the same prior year to the most recent year, but to avoid distortions in scoring or ranking related to pension plans with unfunded accrued liabilities of nominal amounts, the scoring or ranking for both the growth of the unfunded accrued liability over time and the growth of municipal contributions over time will be applicable only if the unfunded accrued liability equals at least 10 percent of the amount of the assets).

Growth of Unfunded Accrued Liability Rate	Scoring or Ranking
0.0- 9.9%	0
10.0-12.4%	10
12.5-14.9%	20
15.0-17.4%	30
17.5-19.9%	40
20.0-22.4%	50
22.5-24.9%	60
25% or over	70

Growth of Municipal Contributions Rate	Scoring or Ranking
20% or over	0
15-19.9%	10
10-14.9%	20
0- 9.9%	30

From the standpoint of the general fiscal condition of a municipality, indication of financial distress can be based on factors which demonstrate utilization of existing tax revenue sources near their maximum potential (high tax burden), substantial indebtedness with limited resources available for repayment of debt, deterioration in revenue base and increasing cost of operating the municipal government which is not offset by revenue growth. The Commission has developed a series of financial indicators to measure these broad areas of concern.

Current tax burden is largely a relative indication of the financial pressure on the revenue sources of a municipality. Both the taxes collected per capita and the trend in that measure are readily comparable among municipalities and are valid indications of the relative tax burden. Both the "adjusted mill rate" of the municipality and the trend in that measure represent comparable and valid indications of the tax level in the principal variable tax revenue source for municipalities, the real property tax. These measures have been ranked to produce a relative indication of the tax burden of municipalities evaluated.

The level of debt, the level of debt relative to the real property tax base, and the costs of debt service relative to total taxes collected directly impact on municipal capacity to finance pension fund obligations.

Total net debt per capita is a comparable measure of the relative debt of municipalities. Evaluating total net debt in terms of the assessed valuation of real property is a comparable measure of the ability of a municipality to repay the accumulated debt using the current real property tax base. Evaluating total net debt in terms of the market value of real property represents a comparable measure of the ability of a municipality to repay accumulated debt using the potential real property tax base. The cost attributable to debt, interest and amortization payments, expressed in relation to the total taxes collected is a comparable measure of the amount of available revenues dedicated to debt service and therefore not available for other purposes including payment of pension fund obligations. These measures of debt have been ranked to produce a relative indication of the debt burden of municipalities evaluated.

The strength of revenue sources is an indication of the potential to maintain current revenues sources. Both the per capita market value and the trend in that measure represent comparable and valid indications of the potential to maintain real property tax revenues. These measures have been ranked to produce a relative indication of the strength of the source of real property tax revenue, market value of property.

The operating position of municipalities is also indicative of the ability to fund pension obligations. Both the per capita total adjusted expenditures to maintain municipal services and the trend in that measure represent comparable and valid indications of the costs of municipal operations. These measures have been ranked to produce a relative indication of the demand for revenues to maintain municipal services.

RECOMMENDATION: The Commission recommends that the municipal finance considerations in the financial distress determination procedure should measure the financial component of financial distress broadly on the basis of the current tax burden, the debt level and its financing requirements, the strength of revenue sources, and the operating position of the municipality. Specifically, the municipal finance indicators and the scoring or ranking attributable to each should be as follows:

a. Amount of tax revenues in relation to population (total taxes collected per capita).

Taxes Collected Per Capita	Scoring or Ranking	Percentage Increase in Taxes Per Capita (latest 5 yr pd)	Scoring or Ranking
$ 0.00-$79.99	0	0.00-19.99%	0
80.00- 84.99	5	20.00-29.99%	3
85.00- 89.99	10	30.00-34.99%	6
90.00- 99.99	15	35.00-39.99%	9
100.00-109.99	20	40.00-44.99%	12
110.00-124.99	25	45.00-49.99%	15
125.00-139.99	30	50.00-54.99%	18
140.00-159.99	35	55.00-59.99%	21
160.00-179.99	40	60.00-64.99%	24
180.00-199.99	45	65.00-69.99%	27
200.00 or greater	50	70.00% or greater	30

b. Real property tax effort (tax rate on the market value of real property, referred to as the "adjusted mill rate").

Adjusted Mill Rate	Scoring or Ranking	Percentage Increase in Adjusted Mill Rate (latest 5 yr pd)	Scoring or Ranking
0.00- 5.99	0	0.00- 3.99%	0
6.00- 7.99	5	4.00- 6.99%	3
8.00- 9.99	10	7.00- 9.99%	6
10.00-11.99	15	10.00-12.99%	9
12.00-12.99	20	13.00-15.99%	12
13.00-13.99	25	16.00-18.99%	15
14.00-14.99	30	19.00-21.99%	18
15.00-15.99	35	22.00-24.99%	21
16.00-16.99	40	25.00-27.99%	24
17.00-17.99	45	28.00-30.99%	27
18.00 or greater	50	31.00% or greater	30

c. Amount of debt in relation to population (total net debt per capita).

Net Debt Per Capita	Scoring or Ranking
$0.00-$9.99	0
10.00-19.99	8
20.00-29.99	16
30.00-39.99	24
40.00-49.99	32
50.00-59.99	40
60.00-69.99	48
70.00-79.99	56
80.00-89.99	64
90.00-99.99	72
100.00 or greater	80

d. Comparison of the amount of debt with the existing real property tax base (total net debt as a percentage of the assessed value of real property).

Percentage	Scoring or Ranking
0.00-0.49%	0
0.50-0.99%	6
1.00-1.99%	12
2.00-2.99%	18
3.00-4.49%	24
4.50-5.99%	30
6.00-6.99%	36
7.00-7.99%	42
8.00-8.99%	48
9.00-9.99%	54
10.00% or greater	60

e. Comparison of the amount of debt with the potential real property tax base (total net debt as a percentage of the market value of real property).

Percentage	Scoring or Ranking
0.00-0.24%	0
0.25-0.49%	6
0.50-0.99%	12
1.00-1.49%	18
1.50-1.99%	24
2.00-2.99%	30
3.00-3.49%	36
3.50-3.99%	42
4.00-4.49%	48
4.50-4.99%	54
5.00% or greater	60

f. Comparison of fixed cost attributable to debt service with revenues available for repayment of debt (debt service as a percentage of total taxes collected).

Percentage	Scoring or Ranking
0.00- 4.49%	0
4.50- 5.49%	8
5.50- 6.49%	16
6.50- 7.49%	24
7.50- 8.49%	32
8.50- 9.49%	40
9.50-10.49%	48
10.50-11.49%	56
11.50-12.49%	64
12.50-13.49%	72
13.50% or greater	80

g. Total market value of real property in relation to population (market value of real property per capita).

Market Value Per Capita	Scoring or Ranking	Percentage Increase in Market Value Per Capita (latest 5 yr pd)	Scoring or Ranking
$8,000 or greater	0	41.00% or greater	0
7,500-7,999	5	39.00-40.99%	3
7,000-7,499	10	35.00-38.99%	6
6,500-6,999	15	31.00-34.99%	9
6,000-6,499	20	27.00-30.99%	12
5,500-5,999	25	23.00-26.99%	15
5,000-5,499	30	19.00-22.99%	18
4,500-4,999	35	15.00-18.99%	21
4,000-4,499	40	11.00-14.99%	24
3,500-3,999	45	7.00-10.99%	27
0-3,499	50	0.00- 6.99%	30

h. Cost of providing municipal services in relation to population (total adjusted expenditures per capita).

Adjusted Expenditures Per Capita	Scoring or Ranking	Percentage Increase in Adjusted Expenditures Per Capita (latest 5 yr pd)	Scoring or Ranking
$0.00-149.99	0	0.00-13.99%	0
150.00-164.99	5	14.00-17.99%	3
165.00-179.99	10	18.00-21.99%	6
180.00-194.99	15	22.00-25.99%	9
195.00-209.99	20	26.00-29.99%	12
210.00-224.99	25	30.00-33.99%	15
225.00-239.99	30	34.00-37.99%	18
240.00-254.99	35	38.00-41.99%	21
255.00-269.99	40	42.00-45.99%	24
270.00-284.99	45	46.00-48.99%	27
285.00 or greater	50	49.00% or greater	30

The Commission is cognizant that in a highly structured determination process, financial distress on the part of a municipal pension system is actually determined by the relative scoring or ranking received by each municipal pension system. A score or rank above a specified point will indicate financial distress on the part of a municipal pension system. The score or ranking for one municipal pension system can also be used to indicate its financial distress relative to all other municipal pension systems.

After examining the indicators chosen and the relative weighting given each, the Commission has concluded that a distress determination score of 360 represents a significant departure from the situation of a well funded pension plan and a financially healthy municipality. A municipality with a distress determination score of 360 has reached an appropriate threshold for designation as a financially distressed municipal pension system and inclusion in at least some of the remedies of the recovery program.

RECOMMENDATION: The Commission recommends that any municipality which receives a total scoring or ranking of at least 360 should be deemed to be financially distressed and be eligible for inclusion in at least some of the remedies which comprise the recovery program.

ENTITY RESPONSIBLE FOR DETERMINATION OF FINANCIAL DISTRESS

After deciding on a procedure for the determination of financial distress on the part of a municipal pension system, the Commission addressed the question of the appropriate governmental entity to make the determination of financially distressed municipal pension systems.

Since the recovery program for financially distressed municipal pension systems which the Commission was required to develop pursuant to Act 66 of 1981 is obviously intended to be a program of application throughout the Commonwealth and will involve the distribution of Commonwealth revenues, it does not appear to be appropriate to rely on local units of government to implement the determination process. The Commission considered it more appropriate to have the determination process implemented by an agency of Commonwealth government, with the additional advantage that the determination process would be implemented on a uniform and standardized basis.

The responsibility to implement the determination process could be handled by either an existing Commonwealth agency or by a newly created Commonwealth agency. In the highly structured process developed by the Commission for the determination of financial distress, responsibility for implementation should be given to an agency with technical expertise and access to the necessary data. Currently, the Department of Community Affairs collects and retains financial data concerning all municipalities (including municipal authorities), and the Public Employee Retirement Study Commission collects and retains actuarial data concerning all municipalities (including municipal authorities and Councils of Governments) pursuant to Act 293 of 1972.

The Commission concluded that the determination of the actuarial component and the municipal finance component by the Commission, with the Department of Community Affairs participating in the calculation of the municipal finance component, gives the responsibility for data analysis to those agencies in the Commonwealth with the greatest access to data and the greatest interest in the program. An overall determination of financial distress by the Commission places sole responsibility for administration of the distress determination procedure with a single agency. The Commission considers annual determination of financial distress necessary to reflect either improvement or decline in the situation of municipal pension systems.

RECOMMENDATION: The Commission recommends that the determination of financial distress for municipal pension systems should be done annually, that the determination should be made by an agency of Commonwealth government and that the agency charged with the ultimate determination of financial distress should be the Public Employee Retirement Study Commission. The calculation of the scoring or ranking of the actuarial component of the determination procedure should be performed by the Commission and the calculation of the scoring or ranking of the municipal finance component of the determination procedure should be performed by the Commission working in concert with the Department of Community Affairs.

INITIATION OF THE FINANCIAL DISTRESS DETERMINATION PROCEDURE

The Commission addressed the question of whether the procedures for determining financial distress in a municipal pension system should be automatic for all municipal pension systems in the Commonwealth or should be initiated only upon the election to participate by the municipality involved. The Commission concluded that initiation of the financial distress determination procedure by the municipalities involved is an appropriate deferral to local judgement on the advisability of undertaking recovery in this manner and accommodating the preconditions for, or consequences of, participation in the determination procedure and the related recovery program.

RECOMMENDATION: The Commission recommends that the procedure for the determination of financial distress should be initiated only upon the election to participate in the program by the governing body of the municipality.

PART III

RECOVERY PROGRAM FOR FINANCIALLY DISTRESSED MUNICIPAL PENSION SYSTEMS

THE NEED FOR A RECOVERY PROGRAM

Act 66 of 1981 mandates that the Commission develop and recommend a recovery program for municipal pension systems which are determined to be financially distressed. Broadly defined, a recovery program would be an attempt to alleviate the problem faced by these financially distressed municipal pension systems either through the provision of one or an assortment of potential remedies which are not currently available to the municipalities involved or through the identification of one or more existing remedies which have not been fully recognized or utilized by the municipalities involved.

The term "recovery" can convey several notions. It can indicate the idea of regaining something that was lost or the idea of the restoration of health in the event of illness. The second notion, the idea of the restoration of health, probably more accurately describes the situation in which financially distressed municipalities find themselves. While the historic poor funding pattern which can be expected to characterize financially distressed municipal pension systems represents lost revenue in the past and a similar lost opportunity for investment, the practice of insufficient or omitted pension plan funding is more akin to a chronic malady. Like a chronic illness, the full extent of the sickness only becomes apparent with time, when it takes on critical proportions. Also like a chronic illness, it can be cured with timely action.

The problem of underfunding municipal pension plan liabilities has been consistently identified by the reports of the Department of Community Affairs prepared in recent years pursuant to Act 293 of 1972, as amended. It was highlighted recently by the work of a select Senate Committee chaired by Senator H. Craig Lewis. With the passage of Act 66 of 1981, creating the Commission and mandating the development of both funding standards for all municipal pension systems and a recovery program for financially distressed municipal pension systems, the General Assembly has indicated that it recognizes this chronic pension funding problem and it has taken the first steps to correct it. Many, but not all, municipalities have previously recognized the problem and some have undertaken limited remedial action.

While the imposition for the first time in the Commonwealth of a general actuarial funding standard will do much to reverse the long standing neglect of pension funding, the Commission has reason to believe that a number of municipalities in the Commonwealth will not have the financial capacity to meet the requirements of the actuarial funding standard without the provision of some additional assistance. These municipalities evidence financial distressed and will require remedies for that distress. These remedies in total will constitute the recovery program.

Financially distressed municipal pension systems are those least likely to be able to meet the actuarial funding standard relying on their present resources. The alternative to the development of a recovery program is to allow the overall municipal pension system in the Commonwealth to continue on its present course, without any substantial intervention by the Commonwealth. Without self-imposed funding standards or funding standards imposed by the Commonwealth, and without some increase in municipal revenue committed for this purpose, the present course will eventually result in the default of one or more municipal pension plans in the Commonwealth. Any default on the part of a municipal pension plan will necessitate the permanent loss of benefits on the part of retirees, bankruptcy proceedings for the municipality involved or reorganization or liquidation pursuant to a state receivership for the pension plan or for the municipality.

The permanent loss of benefits for current retirees and future beneficiaries is, in the view of the Commission, a highly undesirable resolution of the situation of financial distress on the part of a municipal pension system. The Commission finds that the other two possible resolutions are no more desirable. Municipal pension plans in the Commonwealth do not have any separate legal existence, but are funds administered by the municipality, which has a legal relationship with the employees and retirees of a contractual nature. As a component part of a municipality, the municipal pension plan cannot seek the protection from creditors of the federal bankruptcy law without the municipality also utilizing the protection of the federal bankruptcy law. Short of reliance on the federal bankruptcy law, a financially distressed municipal pension plan could resort to some version of reorganization or liquidation pursuant to a state receivership, either restricted solely to the municipal pension plan or applicable broadly to the municipality. This remedy would require future legislative action by the General Assembly and in any conceivable version, would involve a substantial commitment by the Commonwealth of resources and agency time and personnel to accomplish, which may not be feasible or desirable.

RECOMMENDATION: The Commission recommends that there be established a recovery program for municipal pension systems determined to be financially distressed in lieu of any other alternative solution to the condition of financial distress in a municipal pension system.

APPLICATION OF REMEDIES CONTAINED IN THE RECOVERY PROGRAM

With the development of remedies for inclusion in a recovery program for financially distressed municipal pension systems, the Commission considered the proper role for various types of remedies, the legal context for the application and implementation of remedies, and any priority which should be followed in the application and implementation of remedies.

Proper Role for Various Types of Remedies

The various remedies which could comprise a recovery program have numerous implications. They can further certain goals, penalize or make more costly certain practices, induce modifications in certain policies or offset the relationships of various levels of government or entities within a level of government. Some of the implications are restricted to pension matters while others are broader in their scope. For example, the Commission is aware that, while some general or at large remedies may result in an improvement in the broad financial health of most municipal pension systems, those remedies may also result in significant changes for a small number of municipal pension systems which the municipalities may view as undesirable. Also a specific remedy which involves the addition of state money towards financing municipal pension systems, which historically has been a municipal responsibility, may be viewed by some as a shift of this responsibility toward the Commonwealth. Very few remedies have no implications. In developing remedies for financial distress in municipal pension systems, the Commission has attempted to identify and examine the potential implications for each remedy in order to avoid the most undesirable, unintentional implications.

The Legal Context for the Application of Remedies

In considering the appropriate general, specific, local and state remedies for inclusion in a recovery program for financially distressed municipal pension systems, the Commission recognized that there exists a legal context into which a recovery program must be adopted.

In the case law development in the Commonwealth over a long period of time, it has been established that the public employee pension benefit is a contractual relationship between the public employee and the municipal employer involved and that the municipal employer bears the ultimate responsibility to pay the retirement benefits to its public employees when those benefits come due. This is true whether or not the Commonwealth participates currently in the financing of the pension plan through the foreign casualty or foreign fire insurance premium tax aid. This contractual relationship, and the role of the municipal employer as the ultimate insurer of all public pension benefits, will remain even with the inclusion in the recovery program of a state funded assistance program. Unless legislation is enacted pursuant to which the Commonwealth replaces municipalities as the ultimate insurer of retirement benefits, this relationship will not be modified. The Commission recognizes, however, that it is in the interest of the Commonwealth for public employee pension plans in the Commonwealth to avoid defaults. With a default, there will be strong moral and political pressure for the Commonwealth to intervene and provide substantial assistance. Also, the Commission believes defaults will provide an impetus for federal legislation along the lines of the Employee Retirement Income Security Act (ERISA), specifically a plan termination insurance program.

Priorities for the Application of Remedies

The various remedies which may comprise a recovery program can be classified in two main ways: general or at large remedies as distinguished from specific remedies and remedies, of essentially local government application as distinguished from remedies of essentially state government application. Because of the implications present in various types of remedies and the legal framework into which the recovery program must be adapted, the Commission advocates the establishment of priorities for the application and implementation of the various classifications of remedies. Specifically, the Commission concluded that general or at large remedies should be utilized before specific remedies and that remedies of essentially local government application should be utilized before remedies of essentially state government application.

Requiring a revision of existing revenue sources for pension funding on both the local level and the state level ensures that all current revenue sources for municipal pension systems will be fully utilized and that all possible remedies of a general application will be in place prior to the establishment of specific remedies. Setting the revision of existing revenue sources on the local level as a precondition for the use of any other remedy in the recovery program is appropriate in that it places this potential remedy in its proper place as the initial remedy for use prior to any specific remedies. It also reflects the proper role for other potential remedies for the condition of financial distress by emphasizing the application of local remedies wherever possible in this area historically considered to be a local government responsibility.

In establishing priorities for various remedies, the Commission proposes that those remedies which have implications viewed as serious and adverse and those remedies which have the greatest potential impact on changing the relationship between local governments and the Commonwealth be reserved to apply to only those municipalities in the most acute situation of financial distress.

RECOMMENDATION: The Commission recommends that the recovery program include a variety of remedies for the condition of financial distress in a municipal pension system and that the remedies in the recovery program include both remedies of a general or at large application and remedies of a specific application.

RECOMMENDATION: The Commission recommends that the remedies of a general or at large application be a revision of existing revenue sources for pension funding on both the local level and the state level.

GENERAL OR AT LARGE REMEDIES FOR INCLUSION IN A RECOVERY PROGRAM

Utilization of Existing Local Revenue Sources

The Commission considered various remedies for distress which may be implemented at the local level. Since a municipality will be held responsible for the payment of a portion of any deficiency which exists when the amount of existing financial support is compared to the financing requirements applicable pursuant to the actuarial funding standard, the Commission deemed it essential to identify measures which may be taken to ensure that existing local revenue which may be applied to funding pension obligations is utilized as effectively as possible.

Most of the tax revenue raised by Pennsylvania municipalities is generated through general purpose tax levies, with the real property tax and the earned income tax being the most significant revenue producers. Most municipal functions, including the funding of pension obligations, must be financed through general fund expenditures. The governing body of the municipality exercises discretion in allocating the general fund revenue to finance the various municipal functions. There is no special requirement that pension fund obligations be borne by any particular "dedicated" tax revenue. The only authorizations for dedicated revenue sources for pension funding are found in provisions of the Borough Code and the First Class Township Code, which permit a special purpose real estate levy of up to ½ mill to provide for pensions, retirement or the purchase of annuity contracts for employees.

Because contributions by a municipality to its pension system are typically derived from revenue sources which are subject to statutory rate limits and which must also fund the bulk of municipal operations, the portion of available resources allocated to fund pension obligations, particularly in a municipality determined to be financially distressed, may be insufficient. Before identifying potential new local revenue sources for funding municipal pension systems, the Commission investigated possible means for more effectively utilizing existing revenue sources.

The Commission identified several measures a municipality may be able to implement to assure a more adequate and more rational allocation of revenue to its pension system. In cases where a municipality has established one or more public service enterprise operations, such as a municipal water system maintained on a self-supporting basis, the appropriate employee pension costs attributable to employees of the enterprise operations should be assessed against the enterprise funds. If the cost of providing pensions for employees of enterprise operations are to be charged against the enterprise funds, these costs should also be considered by the municipality in setting the rates or charges which the public must pay for the services provided. Also, where a municipality is receiving federal, state, or private grant funds which are applied to projects involving expenditures for personnel, the employer pension costs attributable to service by employees engaged in activities associated with such projects should be charged against the grant funds. And finally, in cases where other employers, such as municipal authorities, are providing employee pension benefits through the pension system of a general purpose municipality, these employers should be required to pay their appropriate share of the normal cost of the pension system. Since municipal authorities operate independently of the municipalities which created them and are considered to be separate employers with their own revenue generating capacity, the Commission considers it reasonable to expect such authorities to fund the employer pension costs attributable to any authority employees who are participating in a municipality's pension system. As with municipal public service enterprise operations, the employee pension costs should be considered in setting the rates or charges to be paid for the services of the authority.

In addition to these measures which may be implemented directly at the local level, state legislation allowing distressed municipalities to exceed current statutory limits on employer contributions to municipal pension systems will permit municipalities to allocate revenue, whether derived from existing or new sources, to municipal pension systems based on the actual financing requirements of the pension plans. The current provisions of the Third Class City Code, limiting municipal contributions to the police pension fund and the firemen's pension fund to an amount for each fund equal to 3% of all taxes levied by the city for non-debt purposes, impose a limitation on employer contributions which is unrelated to the actual cost of funding the pension plan and which may result in underfunding of pension obligations, regardless of the ability of the city to raise revenue to meet these obligations.

RECOMMENDATION: The Commission recommends that the revision of existing revenue sources for pension funding on the local level be accomplished by ensuring utilization of any omitted or underrepresented local revenue source in the municipalities as a precondition for the use of any other remedy pursuant to the recovery program.

Revision of Existing State Revenue Sources

State assistance to municipalities to offset employee pension costs in 1982 totals approximately $50 million and is derived from the proceeds of a 2% tax on foreign (incorporated out-of-state) casualty and fire insurance premiums. Foreign casualty insurance premium tax monies are allocated to municipalities specifically to offset police pension costs, while foreign fire insurance premium tax monies are allocated to municipalities specifically to offset pension costs for paid firefighters or to transfer to volunteer firemen's relief funds. The municipal allocations of the proceeds from both foreign casualty and fire insurance premium taxes are distributed by the Department of the Auditor General. There is no state assistance provided to municipalities to offset pension costs for non-uniformed employees.

Allocation of the proceeds of the foreign casualty insurance premium tax are governed by Act 120 of 1943 (72 P.S. 2263.1 et seq.), which provides for allocations to the Commonwealth to offset pension costs for the State Police and to Allegheny County and municipalities to offset pension costs for municipal police. The Act provides for the application of four formulas to determine the annual allocations. The formulas provide for allocations based largely on the population served, although a per police officer factor is applied to some extent. Of the $54,235,937 available for distribution in 1982, the amount of $52,533,195, or 97%, was allocated on the basis of population with $1,702,742, or 3%, allocated on a per police officer basis. The Commonwealth's allocation of foreign casualty insurance premium tax proceeds totalled $9,223,149 in 1982, while allocations to municipalities in 1982 totalled $45,492,219.

Allocation of the proceeds from the foreign fire insurance premium tax are governed by Act 289 of 1895 (72 P.S. 2262), which provides for allocations to municipalities to offset pension costs for paid firefighters or to transfer to relief funds administered by volunteer fire company relief associations. Where both paid fire departments and volunteer fire companies render service to the municipality, the Act requires that the municipal allocation be divided equally between the pension fund and the relief fund(s). The allocations are determined by the foreign fire insurance premium tax proceeds attributable to the property insured by out-of-state companies within the geographical confines of each recipient municipality. Of the $20,570,234 available for distribution in 1981, the amount of $8,673,271, or 42.2%, was allocated to municipal pension funds for paid firefighters.

Receipts from both of the current revenue sources for state assistance to municipalities to offset employee pension costs are automatically escalated, as they are derived through imposition of a percentage tax on a base which increases with inflation and other economic factors. The following table, based on information provided by the Department of the Auditor General, shows the actual allocations of both foreign casualty and fire insurance premium taxes from 1971 to 1981.

	Foreign Casualty Insurance Premium Tax Allocations		Foreign Fire Insurance Premium Tax Allocations	
	Amount	Increase	Amount	Increase
1971	$15,708,210	18.0%	$ 6,843,696	12.0%
1972	17,283,011	10.0%	6,971,438	1.9%
1973	17,763,018	2.0%	7,486,134	7.4%
1974	19,605,910	10.4%	7,678,209	2.6%
1975	21,382,585	9.1%	9,303,059	21.2%
1976	24,997,881	16.9%	9,458,134	1.6%
1977	30,191,106	20.8%	11,804,175	24.8%
1978	37,999,626	25.9%	14,200,000	20.3%
1979	44,494,797	17.1%	16,995,405	19.7%
1980	49,145,394	10.5%	19,233,432	13.2%
1981	52,230,328	6.3%	20,570,234	7.0%

The average annual increase in the allocations of foreign casualty insurance premium tax proceeds in the years indicated was approximately 13%, and the average annual increase in the allocations of foreign fire insurance premium tax proceeds in the same years was approximately 12%. Because employee pension costs for municipalities are increased by inflation and other economic factors, the growth of the receipts from the dedicated revenue sources for state assistance to municipalities to offset those costs is beneficial.

The Commission found the allocations of foreign casualty and fire insurance premium taxes to be unrelated to the employee pension costs of recipient municipalities which the state assistance is intended to offset. Allocations of foreign casualty insurance premium tax proceeds range from less than 4% of payroll to as high as 200% of payroll, and the deviation is even greater when expressed in terms of the normal costs of recipient municipal pension plans. Allocations of foreign fire insurance premium tax proceeds to municipal pension funds for paid firefighters range from 1% of payroll to over 25% of payroll, and the deviation is even greater when expressed in terms of the normal costs of the recipient municipal pension plans. In addition, allocations of foreign fire insurance are subject to misallocation due to both improper designation of the municipality in which foreign fire insurance policies are written and the required equal distribution between municipal pension funds and volunteer firemen's relief funds regardless of the relative service rendered to the municipality by the paid fire department and volunteer fire companies.

In the view of the Commission, allocating the state assistance to municipalities to offset employee pension costs in relation to the costs incurred will increase both the efficiency and the effectiveness of the state tax revenues being distributed. Also, providing allocations of state assistance in relation to employee pension costs will establish and ensure an equitable aid program to municipalities based on actual need.

In examining the possible means for allocating state assistance using factors related to employee pension costs, the Commission preferred a formula based on the number of employees participating in a pension plan rather than a formula based on pension plan normal costs. An allocation based on the number of employees will negate the variations in pension benefits and salaries among municipalities and establish a uniform subsidy for all municipalities.

Because municipalities are obligated to maintain the solvency of each of their employee pension funds, the Commission questions, from a financial management standpoint, the practice of distributing state assistance to municipalities to offset employee pension costs in the form of two independent allocations, each dedicated for specified municipal pension funds. The current form of state assistance precludes municipal discretion in allocating state assistance to offset employee pension costs in a fiscally planned manner. The dedicated allocations also prevent application of state assistance to offset pension costs of non-uniformed employees and perpetuate decentralized administration of municipal employee pension systems. The Commission concluded that one non-restricted state assistance allocation to municipalities to offset employee pension costs would reduce administrative costs associated with the allocation of state assistance and would permit municipalities to allocate the monies consistent with local priorities. Due to the contractual obligation of municipalities to pay employee pensions, the security of employee pension benefits will not be impaired with implementation of a non-restricted allocation of state assistance to be used in meeting municipal pension fund obligations.

To preclude the state assistance to municipalities to offset employee pension costs from constituting an incentive to establish employee pension plans, the Commission proposes that allocations of non-restricted state assistance be made only after newly established pension plans have been established and maintained for a period of time.

In proposing a program of non-restricted general state aid for municipal pension plans, with allocation related to employee pension costs, the Commission examined the existing revenue sources for state aid to municipal pension plans and considered various means of providing increased financing for the state aid program. Foreign casualty insurance premium tax receipts are currently allocated to both the Commonwealth and municipalities to offset pension costs for police employees. Unlike foreign fire insurance premium tax receipts, interest earnings on foreign casualty insurance premium tax receipts prior to allocation are not made available for distribution. The Commission proposes making both the total receipts of foreign casualty insurance premium tax and the interest earnings on those receipts prior to distribution available to offset municipal employee pension costs. The Commission also proposes directing a portion of the foreign fire insurance premium tax receipts for allocation under the revised formula. Foreign fire insurance premium tax receipts, and the interest earned on those monies prior to distribution, are currently allocated to municipalities either to offset pension costs of paid firefighters or to transfer to relief funds for volunteer firefighters. Because the allocations to relief funds for volunteer firefighters have historically not been made available for pension purposes, the Commission determined that any revision in the method of allocating state aid to municipal pension plans should apply only to amounts which would be allocated to pension funds for paid firefighters and should not interfere with allocations now directed to relief funds for volunteer firefighters. In establishing the portion of the total receipts which should be made available for distribution under a revised formula, the Commission proposes an annual determination of the amount which would be directed to municipalities for offsetting pension costs for paid firefighters under the distribution formula in effect. That amount would then be set aside for distribution under the revised formula based on number of employees, while allocations to relief associations would proceed as usual under whatever formula is in effect. To provide targeted state assistance to municipalities which will be faced with severe increases in the amount of financing for employee pension costs with implementation of mandated actuarial funding of their pension systems, the Commission advocates imposing a surcharge on foreign fire insurance premiums for policies written on property located in municipalities with pension funds for paid firefighters and allocating the receipts to those municipalities based on the number of paid firefighters. And to accelerate improvement of the actuarial conditions in financially distressed municipal pension systems, the Commission proposes that a portion of the general state aid available for distribution under the revised formula be initially applied under the financial assistance component of the recovery program. The redirected monies would subsequently revert for distribution under the non-restricted general state aid program to offset municipal pension costs.

The Commission recognizes that a change in the current distribution formulas for state assistance to municipalities to offset employee pension costs may impact detrimentally on the financial management of some recipient municipalities. In order to lessen the possibility of abrupt decreases in the amount of state assistance received by individual municipalities, the Commission advocates phasing in the new allocation formula over a period of time.

RECOMMENDATION: The Commission recommends that the revision of existing revenue sources for pension funding on the state level will be accomplished by the establishment of a general municipal pension system state aid program through a restructuring, over a period of years, of the current foreign casualty insurance premium tax aid program and the portion of the current foreign fire insurance premium tax state aid program allocated to pension plans for paid firefighters, with the specifics of the restructuring of the existing state aid programs and the operation of the new general municipal pension system state aid program as follows:

a. that the general municipal pension system state aid program be financed from total receipts from the foreign casualty insurance premium tax, including any amounts currently payable to the State Employes' Retirement System, and any interest earned on those total receipts, and from the portion of the total receipts from the foreign fire insurance premium tax that would be allocated to pension plans for paid firefighters pursuant to the allocation procedure then in force, including any interest earned on those receipts;

b. that general municipal pension system state aid program monies be made available to all cities, boroughs, towns and townships;

c. that the general municipal pension system state aid program monies be allocated on a basis related to employer pension costs;

d. that the general municipal pension system state aid program monies be in the form of a non-restricted allocation to offset municipal employer pension costs;

e. that the allocations from the general municipal pension system state aid program be on a per unit basis, with the number of units attributable to each employee in the following categories as follows:

police officers	two units
firefighters	one unit
non-uniformed employees	one unit

f. that the allocations of general municipal pension system aid be determined on the basis of the number of units attributable to each employee participating in existing pension plans, or any revisions to those pension plans applicable to new employees, including the number of units attributable to each employee participating in pension plans established subsequent to the effective date of the proposed legislation after five years from the date of establishment;

g. that the maximum municipal allocation for any municipality be set at 25 percent of the total allocation, with any amount in excess of the limit allocated to all other municipalities on the same allocation basis;

h. that full implementation of the new general municipal pension system state aid program be phased-in over a four year period commencing in 1984, with the following percentages of the applicable receipts of the foreign casualty and foreign fire insurance premium taxes and interest on those receipts to be distributed in each year:

Year	Percentage distributed pursuant to the general municipal pension system state aid program allocation procedure	Percentage distributed pursuant to the current foreign casualty insurance premium tax state aid program and foreign fire insurance premium tax state aid program allocation procedure
1984	25 percent	75 percent
1985	50 percent	50 percent
1986	75 percent	25 percent
1987	100 percent	0 percent

The general municipal pension system state aid will be distributed in September annually;

i. that commencing in 1984 and for each subsequent year in which the supplemental state assistance program and fund are in operation, 30 percent of the gross amount otherwise available for the general municipal pension system state aid program pursuant to the revised allocation procedure, but not more than 60 percent of the amount certified by the Commission as the appropriation for the supplemental state assistance fund, will be deposited in a separate account established for this purpose in the supplemental state assistance fund. The amount to be distributed from this separate account shall augment the supplemental state assistance and shall be allocated to municipal pension systems determined to be financially distressed. The percentage of the total amount of supplemental state assistance, not including the augmentation, which each municipal pension system determined to be financially distressed is certified to receive shall be calculated. Each municipal pension system shall receive an augmentation amount equal to the same percentage of the total augmentation amount available, but commencing in 1988 and for each subsequent year, the amount of augmentation which any municipality shall be eligible to receive shall not exceed 60 percent of the unaugmented, supplemental state assistance amount. Any undistributed amount in the augmentation account shall revert to the general municipal pension system state aid program for distribution. The augmentation to the supplemental state assistance will be distributed with the supplemental state assistance on the first business day in December annually;

j. that the general municipal pension system state aid program allocations to a municipality with a pension fund for paid firefighters be supplemented with an allocation derived from the revenue generated from a one percent surcharge on premiums for foreign fire insurance policies written on properties located in municipalities maintaining pension funds for paid firefighters. The supplemental allocation will be on the basis of the number of paid firefighters employed by each municipality.

SPECIFIC REMEDIES FOR INCLUSION IN A RECOVERY PROGRAM

In addition to the general or at large remedies for financially distressed municipal pension systems the Commission examined the need for specific remedies for financially distressed municipal pension systems. The specific remedies are those developed for, or applicable to, particular municipalities.

The problem leading to financial distress on the part of municipalities and municipal pension systems is the high relative recognized cost of the respective municipal pension plans with respect to the financial ability which exists to meet it. The specific remedies to be included in a recovery program address the various aspects of this disparity between pension costs and financial ability on the part of a municipality which have given rise to the financial distress. The high relative recognized cost of the municipal pension plans is a function of three items: (1) the number and magnitude of the benefits provided in the benefit plan of the pension plan, (2) the demographic group covered by the benefit plan, and (3) the funding standard used to recognize pension liabilities and determine the portion of the actuarial cost of the pension plan which is attributable to the municipality. The financial ability of the municipality to meet pension plan costs is a function of the utilization of the current and any potential revenue sources by the municipality.

Modification in Funding Standards

One specific remedy for financially distressed municipal pension systems examined by the Commission is the modification of various aspects in the actuarial funding standard used to calculate the required municipal contribution toward the costs of its respective pension plans in order to reduce currently recognized costs. Among the elements of an actuarial funding standard which could be modified in order to result in a reduction in the municipal contribution toward the cost of the respective municipal pension plans which is currently recognized are the amortization period utilized to calculate the contribution required to retire the principal amount of any unfunded accrued liability and the implementation period (phase-in period) employed to make the change from the current level of municipal contributions to the newly revised and required level.

An extension in the amortization period does not change the amount of the pension plan past service liability which is recognized, but does defer to the future some of the financing needed to fund the amount which is currently unfunded. The Commission is aware that extensions of the amortization period beyond 30 years have relatively little impact on reducing the amortization contribution requirement, since the amortization contribution requirement always must exceed the amount required to pay interest on the unfunded accrued liability. This reduction in current costs through the extension of the amortization period will increase the amount of interest ultimately paid on the unfunded accrued liability. Amortization periods greater than 40 years also exceed the maximum amortization period allowed pursuant to the federal private sector pension law, the Employee Retirement Income Security Act (ERISA), for multiemployer private sector pension plans. These were the private sector pension plans which generally had the greatest funding difficulties.

The Commission recognizes that for a number of municipal pension systems in the Commonwealth, the imposition of any funding standard with the requirement of immediate strict compliance would cause a substantial increase in the municipal revenue which must be dedicated to the payment of pension liabilities which have been accrued and that this could cause severe fiscal crises in the affected municipalities. The implementation of a phase-in period to change from the current pattern of municipal pension plan contributions to the requirements of the newly revised municipal pension plan actuarial funding standard will serve to lessen this fiscal disruption.

In determining the appropriate length of a period for phasing in compliance with an actuarial funding standard, the Commission examined the relationship of the phase-in to the amortization period. Any phase-in implementation of an actuarial funding standard often will actually provide a consequent reduction in the amortization period used, since the phase-in period will often involve a period of time where the financing provided will be less than the amount of interest on the deficit. If the phase-in period extends over a substantial portion of the amortization period, then the phase-in will be counterproductive, since it leaves a remaining amortization period which is too short. The Commission determined that any increase in the phase-in implementation period will be done in conjunction with a reexamination of the specified amortization period.

New Local Revenue Sources

In order to enable municipalities which are determined to be distressed to meet pension fund financing requirements which cannot be met with existing state and local revenue sources and any state supplemental assistance which is made available, the Commission identified potential new local revenue sources for funding pension obligations. These new local sources include increasing the capacity of a municipality to raise tax revenue for financing employer contributions to municipal pension systems and enabling a municipality to increase the level of support to the pension system provided through employee contributions.

The Commission considered the establishment of new tax levying authority through the removal of statutory limits imposed on existing taxes to be a viable means of providing increased local funding for municipal pension obligations. The Commission concluded that removal of statutory rate limits on taxes which are broad based and which are commonly used to generate significant portions of municipal revenue, such as the earned income and real property taxes, will provide the most reliable, generally applicable relief from current restraints on municipal revenue raising capacity. In addition, removal of statutory rate limits on more than one existing tax will provide a municipality with some flexibility to choose, as a revenue source for providing needed additional funding for the municipal pension system, a tax or combination of taxes proven effective in producing revenue for that municipality and suitable to the individual local tax base. Allowing additional revenue to be raised through the removal of rate limits on existing taxes has the added advantage of being able to be implemented using collection and administrative procedures which are already in place in the municipality.

Since the authority to exceed statutory rate limits on existing taxes would be granted solely on the basis that such authority is necessary to enable a municipality to meet financing requirements for its municipal pension systems, the Commission considers it reasonable to require that the revenue derived from such new taxing authority be dedicated to funding municipal contributions to employee pension funds. In addition, it is reasonable to assume that the amount of local financing currently derived from existing revenue sources and allocated by the municipality to fund municipal pension obligations can be maintained at least at the current level. Any new special taxing authority provided for funding municipal pension obligations should, in the view of the Commission, actually enhance the capacity of a municipality to provide local support for its pension system, rather than merely enabling the municipality to transfer the burden of the current support from existing revenue sources to new revenue sources. In order to ensure that any special purpose tax levies which are authorized are used exclusively to increase the level of funding provided by a municipality to its pension system, the Commission believes that a municipality exercising the new taxing authority should be required to maintain total municipal contributions to employee pension funds from pre-existing revenue sources at the same percentage of payroll as in the year (or an averaged percentage of payroll for several years) prior to implementation of the new dedicated tax levy.

In addition to municipal contributions, employee contributions represent the other substantial source of local financing for municipal pension systems. In order to provide the means to properly balance the burden of financing benefit plans between employees and employer, the Commission believes that municipalities should be authorized to, or required to, establish a minimum employee contribution which is related to the normal cost of the applicable benefit plan. Employee contributions are not uniformly required under the various laws governing municipal pension plans in Pennsylvania. Where employee contributions are specified, they are frequently set as a minimum percentage of salary. Employee contributions can also be set as a specified portion of the normal cost of the pension plan, which is the ongoing cost of the benefit plan. Setting employee contributions in relation to normal cost ensures that public employees finance a specified portion of their own benefits. Any requirement for minimum employee contributions, or any increase in the amount of employee contributions, will reduce any potential deficiency in the amount of financial support when compared to the financing requirements pursuant to the funding standard.

New State Revenue Sources

Although the municipalities are obligated to fund their employee pension systems, the Commission recognizes that the state has an interest in ensuring the financial solvency of its local governments. Due to the historic absence of actuarial funding standards, municipalities have unfunded accrued liabilities to employee pension systems in excess of $2 billion. The funding required to amortize this liability varies among municipalities, but in many instances the demand on local revenue sources may be excessive, particularly in the years immediately following imposition of mandated actuarial funding standards. The Commission considers the provision of supplemental state assistance to municipalities with pension systems determined to be financially distressed to be an appropriate means to reduce the impact of drastically increased municipal contributions to employee pension systems attributable to implementation of an actuarial funding standard. Since the Commission conceives supplemental state assistance to be an interim measure, general fund appropriations by the General Assembly are considered to be an appropriate means to fund the variable need. Potential revisions of current state assistance, the potential reduction of normal costs and the potential increase in employee contributions will independently impact on the total amount of supplemental assistance required, and allocating supplemental state assistance monies to municipalities with financially distressed pension systems in relation to their funding deficiencies, as proposed by the Commission, will impact on the amount of funding needed annually. Due to the variable annual funding requirements for a supplemental state assistance program, an annual determination of the necessary funding is deemed appropriate. Although improvement in the financial condition of distressed municipal pension systems will ultimately negate the need for supplemental state assistance, the Commission believes that legislation establishing a supplemental state assistance program should contain sunset provisions to ensure that the Commonwealth will not permanently fund a program intended to provide short term financial relief to selected municipalities.

Reduction in Pension Costs

Municipal pension costs are largely a function of the pension benefits provided and the amount of non-municipal monies available to offset the costs attributable to the pension benefits. Current state legislation in many instances specifies maximum and minimum benefit levels. As reduced costs are a remedy for financial distress, modifying the benefit structure of employee pension plans to reduce costs is an option which, in the opinion of the Commission, should be made available to municipalities. Due to the contractual nature of employee pension benefits judicially established in the Commonwealth, modification of the benefit structure of employee pension plans requires acquiescence or formal approval on the part of municipal employees. In addition, modification of the benefit structure for current employees may cause employee hardships and morale problems due to the assumed fulfillment of the commitment to provide the pension benefits formally specified at the time of employment or subsequent to employment. Since contractual obligations do not exist between municipalities and their future employees, the Commission concluded that reduction of the pension costs for employees hired in the future is a potential, long-term remedy for financially distressed municipal pension systems.

The Commission proposes permitting or requiring municipalities with pension systems which have a substantial ongoing benefit cost (high normal cost for the benefit plan) to establish a revised benefit plan with a lower ongoing benefit cost applicable to all municipal employees newly hired after the municipality begins to participate in the financially distressed municipal pension system recovery program. Where the cause of financial distress can be traced to actuarial factors and is due in large part to a high ongoing benefit cost rather than a large requirement to amortize an unfunded accrued liability attributable to past omitted municipal contributions, a revision of the benefit plan will remedy the situation for future employees, to whom no current contractual obligation is owed, and will result in a future reduction in the overall cost of the municipal pension system.

Limitation on Benefit Increases

For municipal pension systems which are in financial distress, where there are severe problems in providing financing equal to the funding requirements of the current benefit plan, it is viewed by the Commission to be ill advised for the municipality to improve the benefit plan and thereby increase the funding requirements of the benefit plan. Such an occurrence would weaken the financing of the municipal pension system. The Commission concluded that, as a consequence of participation in the recovery program, severely distressed municipalities should be prohibited from granting or allowing any improvement in the benefit plan for the duration of participation in the program.

Aggregation of Trust Funds

For municipal pension systems which are in considerable financial distress, there is a strong probability that one or more of the municipal pension plans face the potential of a cash flow or liquidity problem and a default in the payment of retirement annuities and benefits to benefit recipients. This is the worst aspect of financial distress which a municipal pension system can suffer.

With the creation of a single trust fund in a municipality to aggregate the liabilities and the assets of the various municipal pension plans, any possibility of default in one of the pension plans can be either avoided or substantially postponed. The procedure would be analogous to the consolidation of various debts on the part of a debtor who is in financial difficulty. A single trust fund would allow for a better handling of pension fund obligations by the municipality, which is ultimately responsible for funding the various municipal pension plans, and may also allow for some "economy-of-scale" savings with respect to administrative functions which may previously have been carried out separately with respect to each municipal pension plan.

The Commission advocates, among the remedies included in a recovery program for financially distressed municipal pension systems, permitting or requiring municipalities to aggregate any assets and liabilities of any municipal pension plan into a common pension trust fund in the municipality.

Improved Administrative Procedures

As a precondition for participation in the recovery program, the Commission proposes that severely distressed municipalities be required to submit plans and a timetable for the improvement of various administrative procedures in connection with their pension plans, such as proposals for the improvement of investment performance, for the increase in liquidity of invested assets, for the better projection of future cash flow requirements, for the reduction in any time delays for the transfer of member deductions and municipal contributions to the pension plan and for the enhancement of the collection of any other accounts receivable. Any of these improvements in administrative procedures will result in a strengthening of the financing of the municipal pension system.

Prior Compliance with any Applicable Funding Standard

With the development of a funding standard for all municipal pension systems in the Commonwealth and the eventual participation by the Commonwealth in the financing of those municipal pension systems which are in considerable financial distress, the Commonwealth has an interest in insuring that the financial distress at any point in time was not as a result of a failure on the part of the municipality involved to comply currently with any applicable funding standards in effect. As an extraordinary remedy for a crisis situation, the Commission deems it appropriate to require a prior good faith effort to conform with applicable funding standards as a precondition for participation in the recovery program.

PROVISION OF VARYING SETS OF REMEDIES TO APPLY TO VARYING DEGREES OF FINANCIAL DISTRESS

In developing a recovery program for financially distressed municipal pension systems, the Commission examined two broad ways in which the remedies could be provided. One would be the provision of the full range of potential remedies for financial distress to all municipal pension systems which have been determined to have met the minimum threshold condition of financial distress. The other would be the provision of varying sets, tiers or levels of remedies to financially distressed municipal pension systems based on the determination of their relative conditions of financial distress.

The Commission concluded that provision of varying levels of remedies is most appropriate since financially distressed municipal pension systems run a broad range of conditions of distress, the financial distress determination process is sufficiently refined to distinguish between various degrees of financial distress and the various remedies involve adverse policy implications or impacts on the relationship between local governmental units and the Commonwealth.

The Commission has structured a program of specific remedies with various levels of participation in order to provide for differentiation between degrees of distress in municipal pension systems and allow for implementation of remedial measures appropriate to the administrative and financial need existing in individual municipalities.

RECOMMENDATION: The Commission recommends that the remedies of a specific application include modifications in the applicable funding standards, the provision of new revenue sources on both the local level and on the state level and the revision of benefit plans to generate a reduction in pension plan cost, and that the remedies of a specific application be structured to match available remedies to degrees of financial distress and to give first priority to specific remedies of local government application and then to specific remedies of state government application. The specific remedies portion of the recovery program would be structured as follows:

a. RECOVERY PROGRAM LEVEL I -

All municipalities with non-distressed employee pension systems and any municipalities with distressed employee pension systems not electing to participate in Level II or Level III will continue to operate the employee pension plans pursuant to current and subsequent statutory provisions, with the option to:

1. Aggregate the various employee pension trust funds into a single pension trust fund.

2. Deviate from any employee contribution limits established pursuant to law or charter to implement revised employee contributions, expressed as a percentage of covered payroll, representing

   (a) not more than 50% of pension plan normal costs in the case of existing pension plans, and

   (b) not less than 30% nor more than 50% of pension plan normal costs in the case of revised pension plans adopted subsequent to the enactment of this proposed legislation.

b. RECOVERY PROGRAM LEVEL II -

Municipalities electing to apply to the Commission for a distress determination subsequently certified as having a distress determination of at least 360 point will be permitted to:

1. Provide municipal funding in excess of any limitations for municipal contributions to employee pension funds contained in state law or home rule charters.

2. Exceed statutorially established limits on earned income and real property taxes provided: (a) that taxes for both revenue sources are currently imposed at the mandated limits; (b) that the revenues derived from any increases in the taxes above statutory limits are dedicated to employee pension funds; and (c) that total municipal contributions to employee pension funds from all revenue sources existing prior to this special taxing authority, expressed as a percentage of covered payroll, are not reduced below the average of the total annual municipal contributions expressed as percentages of payroll, made in calendar years 1980, 1981 and 1982.

3. Defer compliance with the mandated actuarial funding standard by adopting a ten year phase-in period for full compliance. Under the ten year phase-in the required contribution to the municipal pension plan annually would be equal to the contribution made in the previous year plus the following percentage of the difference between that contribution and the full normal cost and amortization of the unfunded accrued liability contribution for each year during the phase-in:

Year After Enactment of Funding Standard	Percentage Between Prior Year's Contribution and Full Requirement
1	10 percent
2	20 percent
3	30 percent
4	40 percent
5	50 percent
6	60 percent
7	70 percent
8	80 percent
9	90 percent
10 and thereafter	100 percent

4. Deviate from any employee contribution limits established pursuant to law or charter to implement revised employee contributions, expressed as a percentage of covered payroll, representing

(a) not more than 50% of pension plan normal costs in the case of existing pension plans, and

(b) not less than 30% nor more than 50% of pension plan normal costs in the case of revised pension plans adopted subsequent to the enactment of this proposed legislation.

5. Adopt revised pension plan benefit structures applicable to new employees, regardless of minimum benefits specified in current statutes, provided that the revised pension plans for new employees require employee contributions, expressed as a percentage of covered payroll, representing not less than 30% nor more than 50% of the normal costs of the revised pension plan. The normal cost of the revised pension plan shall be determined initially through an actuarial valuation by applying the benefit plan of the revised pension plan to the covered active population of the prior pension plan.

6. Aggregate trust funds for employee pension plans and, upon certification that employee pension costs are being properly assessed against enterprise funds, federal and state grant funds, and other employers providing employee pension benefits through the municipal pension system, obtain eligibility for allocations of supplemental state assistance.

c. RECOVERY PROGRAM LEVEL III -

Municipalities electing to apply to the Commission for a distress determination and subsequently certified as having a distress determination of at least 500 points are permitted to elect any of the following optional items indicated and are required to implement the following mandated items:

OPTIONAL ITEMS

1. Exercise any of the options available pursuant to Level II; and

2. Defer compliance with the mandated actuarial funding standard by (a) extending the required amortization period for accrued unfunded liabilities to a maximum of 40 years, (b) increasing the phase-in period for full compliance with the actuarial funding standard to a maximum of fifteen (15) years, or (c) both.

MANDATED ITEMS

1. Implement the Level II option providing for the adoption of revised pension plan benefit structures applicable to new employees regardless of minimum benefits specified in current law or charter, but not in excess of the maximum benefits specified in the current law or charter when expressed in terms of the normal cost of the pension plan estimated using the current pension plan membership data, provided that the pension plan for new employees require employee contributions, expressed as a percentage of covered payroll, representing not less than 30%, nor more than 50%, of the normal cost of the revised pension plan.

2. Submit a comprehensive plan for administrative improvements in their municipal pension plans, subject to approval by the Commission, prior to obtaining eligibility for supplemental state assistance.

3. Implement the Level II option providing for the aggregation of employee pension trust funds and, upon certification that employee pension costs are being properly assessed against enterprise funds, federal and state grant funds, and other employers providing employee pension benefits through the municipal pension system, obtain eligibility for allocations of supplemental state assistance.

4. Refrain from any modifications in the benefit plan which would have the result of increasing either the normal cost or prior service cost of the pension plan as determined through an actuarial valuation for the duration of the receipt of supplemental state assistance monies.

d. RECOVERY PROGRAM - SUPPLEMENTAL STATE ASSISTANCE PROGRAM AND FUND

Supplemental state assistance will be provided for municipal pension systems determined to be financially distressed in proportion to the degree of distress. The receipt of supplemental state assistance will be pre-conditioned on compliance with any actuarial funding standard in effect and in accordance with the provisions of the remedial program for municipal pension systems. The allocation of supplemental state assistance will be made pursuant to a formula which does not produce a significant difference between allocations to municipalities with scores immediately above the distress determination point total necessary for eligibility and municipalities with scores immediately below that distress determination level. Allocations to municipalities shall be determined by expressing the municipalities distress determination points in excess of 300 points as a percentage of the maximum distress determination points and applying the resultant percentage to the difference between the current level of financial support for the pension plans in the municipality, excluding any amounts received pursuant to the supplemental state assistance program, and the contributions required pursuant to the actuarial funding standard if fully implemented. An interest bearing supplemental state assistance fund for the program will be established and funded through annual general fund appropriations based on the Commission's certification of the monies needed, not to exceed $35,000,000 in any year. The initial appropriation to the supplemental state assistance fund shall be deposited on the last business day in November 1987, and annually thereafter. The supplemental state assistance fund will be maintained and allocations from the fund will be disbursed, upon certification by the Commission, by the

Department of the Auditor General. The authority of the Commission to certify appropriations to the supplemental state assistance fund will expire 15 years after the year in which the initial distribution of assistance from the fund or upon the absence in any year of eligible recipients, whichever occurs earlier. The supplemental state assistance will be distributed on the first business day in December annually.

Emergency loan procedures for municipalities facing imminent default in the payment of pension benefits by one or more of their pension plans will also be established. The allocations previously payable to the State Employes' Retirement Fund pursuant to the current allocation formula for foreign casualty insurance premium tax proceeds in the period 1984-1987 will be deposited in the supplemental state assistance program fund. Amounts from the fund including the augmentation account shall be made available for disbursement by the Department of the Auditor General upon certification by the Commission as emergency loans to municipalities with acute cash flow problems in meeting employee pension obligations, with repayment of these loans from future allocations of Commonwealth monies pursuant to a plan submitted by the municipality and approved by the Commission.

APPROPRIATE TIMING FOR THE IMPLEMENTATION OF VARIOUS REMEDIES

With the establishment of a recovery program for municipal pension systems which are determined to be financially distressed, the Commission addressed the appropriate timing for the implementation of the remedies provided in that recovery program.

In a recovery program involving a number of potential remedies, and especially in a recovery program as proposed by the Commission involving varying sets, levels or tiers of potential remedies, the question of timing is crucial. Timing considerations involve both differentiations in implementation required by the nature of the potential remedies involved and differentiations in implementation required by administrative difficulties present.

Implementing various portions of the total recovery program at various points in time in the future will allow for the component parts to be put into effect prior to the introduction of significant state financial assistance. The actuarial funding standard and revised actuarial reporting set the basis for the balance of the program, and allow for reliability in the determination of financial distress from an actuarial standpoint. The revision of current revenue sources on both the local and state levels will provide additional revenue and will rationalize the existing pension plan financing effort as a necessary step towards any additional state assistance. The Commission recommends an emergency loan program to insure that no defaults by municipal pension plans occur prior to the full implementation of the supplemental state assistance program. The Commission proposes that all other elements of the financing of municipal pension plans be revised and in place before supplemental state assistance is provided to the municipal pension systems suffering the greatest degree of financial distress.

RECOMMENDATION: The Commission recommends that the elements of the remedial program be implemented in sequence with the actuarial funding standards initially effective for municipal budgets set in 1984 based on the 1982 actuarial reporting pursuant to Act 293 of 1972, the comprehensive recovery program except for regular allocations pursuant to the supplemental state assistance program effective in 1984, the emergency loan procedure pursuant to the supplemental state assistance program also effective in 1984, the actuarial funding standards fully effective for municipal budgets set in 1985 based on the revised actuarial reporting required pursuant to this proposed legislation and the regular allocations pursuant to the supplemental state assistance program effective in 1987.

RECOMMENDATION: The Commission recommends that the proposed legislation include a provision instructing the Commission to recommend the necessary legislation amending existing municipal pension laws to effect consistency of those laws with the provisions of this proposed legislation establishing the municipal pension system remedial program within one year of the enactment of the proposed legislation.

APPENDIX

COMPOSITE RECOMMENDATIONS OF THE PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION ON MUNICIPAL PENSION PRIORITIES

RECOMMENDATIONS OF THE PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION ON MUNICIPAL PENSION PRIORITIES

Actuarial Funding Standards

The Commission recommends the following concerning the implementation of actuarial funding standards:

(1) that a full actuarial funding goal be adopted, using an actuarial valuation method under which pension plan liabilities are, to the extent possible, recognized concurrently or coincidentally with the rendering of the service by pension plan participants from which they arise and requiring that sufficient financing be provided to the pension plan to match the pension plan liabilities as they are recognized;

(2) that a funding method be adopted which produces both a short term and a long term cost incidence pattern for this benefit of employment which is level as a percentage of covered payroll;

(3) that an actuarial valuation method be adopted which is uniform and standard for all municipal pension plans in the Commonwealth which are self-insured either in whole or in part unless compelling reasons on an individual basis can be demonstrated by a particular municipal pension fund, pursuant to rules and regulations adopted by the Commission, that an alternative actuarial valuation method should be used, and that the actuarial valuation method be the entry age normal actuarial cost method, with the entry age established as the actual entry age for all plan members;

(4) that a differentiation be made in the application of the funding standard between defined contribution and defined benefit plans and between plans which are fully insured by an authorized insurance carrier and plans which are self-insured in whole or in part. The funding standard would differentiate between the various types of pension plans as follows:

Type of Plan	Application of Funding Standard
Defined Benefit Plan - Self-Insured	Full application of funding standard recommended by Commission.
Defined Benefit Plan - Partially Insured by an Authorized Insurance Carrier	Full application of funding standard recommended by Commission.
Defined Benefit Plan - Fully Insured by an Authorized Insurance Carrier	Exception from funding standard recommended by Commission in favor of Commonwealth insurance laws and regulations.
Defined Contribution Plan - Totally Self-Insured	Application of funding standard recommended by Commission limited to requirement that contributions be made as required by the plan and that actuarial assumptions be verified by periodic experience study.
Defined Contribution Plan - Partially Insured by an Authorized Insurance Carrier	Application of funding standard recommended by Commission limited to requirement that contributions be made as required by the plan and that actuarial assumptions be verified by periodic experience study.
Defined Contribution Plan - Fully Insured by an Authorized Insurance Carrier	Exception from funding standard recommended by Commission in favor of Commonwealth insurance laws and regulations.

(5) that best estimate explicit economic and demographic actuarial assumptions be used in preparing any required actuarial valuations. The best estimate explicit actuarial assumptions shall be determined by the board of trustees of and the actuary retained by each municipal pension plan, with specification by the Commission of a narrow range of economic actuarial assumptions which could be utilized without the provision of additional documentation, but in the event of economic actuarial assumptions not contained within the specified narrow range, the economic assumptions could be utilized if an explanation and justification for the assumptions chosen is provided;

(6) that each actuarial valuation report provide an analysis of the increase or decrease in the unfunded accrued liability of the pension plan, including an indication of increases or decreases due to modifications in the benefit plan, changes in actuarial assumptions, deviations in actual experience from the assumed experience, payments to amortize the unfunded accrued liability of the pension plan or other reasons, or provide an explanation and justification of the appropriateness of the omission of this analysis;

(7) that periodically an experience investigation of the pension plan be conducted to compare the actual experience of the plan with the experience expected pursuant to those actuarial assumptions which significantly affect the results of the actuarial valuations of the pension plan;

(8) that, for purposes of determining unfunded accrued liability and other related purposes, assets be valued to accommodate asset mix and reduce the impact of market fluctuations in accordance with rules and regulations adopted by the Commission;

(9) that, for each municipal pension plan with a defined benefit plan, the funding standard require the payment in addition to normal cost of an amount sufficient to amortize any unfunded accrued liability on a level annual dollar basis with the following amortization periods:

Type of Unfunded Accrued Liability	Amortization Period
Unfunded accrued liability existing on the date of enactment.	30 years
Unfunded accrued liability attributable to a change in actuarial assumptions	20 years
Unfunded accrued liability attributable to modifications in the benefit plan (benefit increases) for active members	20 years
Unfunded accrued liability attributable to post retirement adjustments granted to retired members and other benefit recipients	10 years
Unfunded accrued liability attributable to net experience losses	15 years

(10) that the actuarial valuation method used as the basis for the funding standard be applicable to all of the component parts of the benefit plan;

(11) that actuarial valuation for all defined benefit plans which are self-insured in whole or in part be required on a biennial basis if the municipality has not previously applied and is not applying for supplemental state assistance provided in the recovery program, or on an annual basis if the municipality has previously applied or is applying for supplemental state assistance provided in the recovery program;

(12) that the cost of actuarial valuations be an allowable administrative expense payable from the assets of the pension plan;

(13) that the municipality which established and maintains the pension plan be responsible for making any portion of the required funding standard contribution which is not made by member contributions or any applicable state casualty or fire insurance revenues;

(14) that, initially, the penalty for failure to comply with the legal requirements of the municipal pension plan funding standard be the reporting of that failure to comply to the Governor, General Assembly and other interested parties;

(15) that the state agency charged with monitoring compliance with the municipal pension plan funding standard be the Commission, through use of the Act 293 of 1972 actuarial reporting mechanism.

Determination of Distress

The Commission recommends the following concerning the determination of financially distressed municipal pension systems:

(1) that in determining whether or not a municipal pension system is financially distressed, the appropriate definition of a municipal pension system is the municipality as a whole, considering its various pension plans in aggregate;

(2) that for purposes of the municipal pension system financial distress determination, municipal authorities, Councils of Governments and regional governmental entities created pursuant to the Intergovernmental Cooperation Act should be considered to be municipalities separate from any other municipalities with which they may be associated;

(3) that the procedure for the determination of whether or not a municipal pension system is financially distressed and the degree of that financial distress should be made in a highly structured, mechanical and quantifiable manner;

(4) that the financial distress determination procedure should take into account both actuarial considerations, the actuarial condition of the aggregated pension systems of the municipality, and municipal finance considerations, the ability of the municipality to raise the necessary revenue for this purpose;

(5) that the actuarial considerations component and the municipal finance considerations component in the financial distress determination procedure should each be given equal weighting in making the determination of whether or not a municipal pension system is financially distressed and the extent of that distress;

(6) that the actuarial considerations in the financial distress determination procedure should measure the actuarial component of financial distress broadly, with a long term orientation, on the basis of the imminence of default, the past departure from sound funding principles and the existence of substantial future costs attributable to the requirements of the benefit plan in force. Specifically, the actuarial indicators and the scoring or ranking attributable to each should be as follows:

a. Comparison of accumulated reserves with current disbursements (pay-as-you-go) funding requirement (current annuities and retirement benefits payable as a percentage of current plan assets).

Percentage	Scoring or Ranking
0 - 5%	0
6 -10%	10
11-15%	20
16-20%	30
21-30%	40
31-40%	50
41-50%	60
51-60%	70
61-70%	80
71-80%	90
81% or greater	100

b. Comparison of the overall liability undertaken by the pension plan with accumulated reserves (current plan assets as a percentage of the accrued liability of the plan).

Percentage	Scoring or Ranking
50% or greater	0
40 - 49%	10
30 - 39%	20
25 - 29%	30
20 - 24%	40
15 - 19%	50
10 - 14%	60
7.5- 9%	70
5.0-7.4%	80
2.5-4.9%	90
0-2.4%	100

c. Size of the cost of the current total benefit plan to the employer (normal cost of the plan less the rate of any member contributions plus the rate of any employer Social Security contributions on total covered payroll, all expressed as a percentage of covered payroll).

Size (as percentage of payroll)	Scoring or Ranking
0- 9.99%	0
10.00-11.99%	10
12.00-12.99%	20
13.00-13.99%	30
14.00-14.99%	40
15.00-15.99%	50
16.00-16.99%	60
17.00-17.99%	70
18.00-18.99%	80
19.00-19.99%	90
20.00% or greater	100

d. Comparison of the obligation to fund the current unfunded accrued liability of the plan with the normal cost of the plan (result of dividing the requirement to amortize the unfunded accrued liability of the plan on a level basis over the amortization period expressed as a percentage of payroll by the normal cost of the plan expressed as a percentage of payroll).

Result	Scoring or Ranking
0-0.39	0
0.40-0.79	10
0.80-1.19	20
1.20-1.39	30
1.40-1.59	40
1.60-1.79	50
1.80-1.99	60
2.00-2.19	70
2.20-2.39	80
2.40-2.59	90
2.60 or over	100

e. Comparison of current regular contributions with the full amortization requirement (difference between normal cost plus the amount required to amortize on a level basis the unfunded accrued liability over the specified period and the total member contributions, municipal contributions and amounts received from the foreign casualty insurance premium tax state aid program, the paid firefighters foreign fire insurance premium tax state aid program or the general municipal pension system state aid program, whatever is applicable, received by the plan for the previous year, all expressed as a percentage of payroll).

Difference (as percentage of payroll)	Scoring or Ranking
0- 2.4%	0
2.5- 4.9%	10
5- 9.9%	20
10-14.9%	30
15-19.9%	40
20-24.9%	50
25-29.9%	60
30-34.9%	70
35-39.9%	80
40-44.9%	90
45% or over	100

f. Comparison of the growth of the unfunded accrued liability over time with the growth of municipal contributions to the plan over time (relationship between the compound percentage rate of increase representing the increase in the unfunded accrued liability from a prior year to the most recent year and the compound percentage rate of increase representing the increase in municipal contributions to the plan from the same prior year to the most recent year, but to avoid distortions in scoring or ranking related to pension plans with unfunded accrued liabilities of nominal amounts, the scoring or ranking for both the growth of the unfunded accrued liability over time and the growth of municipal contributions over time will be applicable only if the unfunded accrued liability equals at least 10 percent of the amount of the assets).

Growth of Unfunded Accrued Liability Rate	Scoring or Ranking
0.0- 9.9%	0
10.0-12.4%	10
12.5-14.9%	20
15.0-17.4%	30
17.5-19.9%	40
20.0-22.4%	50
22.5-24.9%	60
25% or over	70

Growth of Municipal Contributions Rate	Scoring or Ranking
20% or over	0
15-19.9%	10
10-14.9%	20
0- 9.9%	30

(7) that the municipal finance considerations in the financial distress determination procedure should measure the financial component of financial distress broadly on the basis of the current tax burden, the debt level and its financing requirements, the strength of revenue sources, and the operating position of the municipality. Specifically, the municipal finance indicators and the scoring or ranking attributable to each should be as follows:

a. Amount of tax revenues in relation to population (total taxes collected per capita).

Taxes Collected Per Capita	Scoring or Ranking	Percentage Increase in Taxes Per Capita (latest 5 yr pd)	Scoring or Ranking
$ 0.00-$79.99	0	0.00-19.99%	0
80.00- 84.99	5	20.00-29.99%	3
85.00- 89.99	10	30.00-34.99%	6
90.00- 99.99	15	35.00-39.99%	9
100.00-109.99	20	40.00-44.99%	12
110.00-124.99	25	45.00-49.99%	15
125.00-139.99	30	50.00-54.99%	18
140.00-159.99	35	55.00-59.99%	21
160.00-179.99	40	60.00-64.99%	24
180.00-199.99	45	65.00-69.99%	27
200.00 or greater	50	70.00% or greater	30

b. Real property tax effort (tax rate on the market value of real property, referred to as the "adjusted mill rate").

Adjusted Mill Rate	Scoring or Ranking	Percentage Increase in Adjusted Mill Rate (latest 5 yr pd)	Scoring or Ranking
0.00- 5.99	0	0.00- 3.99%	0
6.00- 7.99	5	4.00- 6.99%	3
8.00- 9.99	10	7.00- 9.99%	6
10.00-11.99	15	10.00-12.99%	9
12.00-12.99	20	13.00-15.99%	12
13.00-13.99	25	16.00-18.99%	15
14.00-14.99	30	19.00-21.99%	18
15.00-15.99	35	22.00-24.99%	21
16.00-16.99	40	25.00-27.99%	24
17.00-17.99	45	28.00-30.99%	27
18.00 or greater	50	31.00% or greater	30

c. Amount of debt in relation to population (total net debt per capita).

Net Debt Per Capita	Scoring or Ranking
$0.00-$9.99	0
10.00-19.99	8
20.00-29.99	16
30.00-39.99	24
40.00-49.99	32
50.00-59.99	40
60.00-69.99	48
70.00-79.99	56
80.00-89.99	64
90.00-99.99	72
100.00 or greater	80

d. Comparison of the amount of debt with the existing real property tax base (total net debt as a percentage of the assessed value of real property).

Percentage	Scoring or Ranking
0.00-0.49%	0
0.50-0.99%	6
1.00-1.99%	12
2.00-2.99%	18
3.00-4.49%	24
4.50-5.99%	30
6.00-6.99%	36
7.00-7.99%	42
8.00-8.99%	48
9.00-9.99%	54
10.00% or greater	60

e. Comparison of the amount of debt with the potential real property tax base (total net debt as a percentage of the market value of real property).

Percentage	Scoring or Ranking
0.00-0.24%	0
0.25-0.49%	6
0.50-0.99%	12
1.00-1.49%	18
1.50-1.99%	24
2.00-2.99%	30
3.00-3.49%	36
3.50-3.99%	42
4.00-4.49%	48
4.50-4.99%	54
5.00% or greater	60

f. Comparison of fixed cost attributable to debt service with revenues available for repayment of debt (debt service as a percentage of total taxes collected).

Percentage	Scoring or Ranking
0.00- 4.49%	0
4.50- 5.49%	8
5.50- 6.49%	16
6.50- 7.49%	24
7.50- 8.49%	32
8.50- 9.49%	40
9.50-10.49%	48
10.50-11.49%	56
11.50-12.49%	64
12.50-13.49%	72
13.50% or greater	80

g. Total market value of real property in relation to population (market value of real property per capita).

Market Value Per Capita	Scoring or Ranking	Percentage Increase in Market Value Per Capita (latest 5 yr pd)	Scoring or Ranking
$8,000 or greater	0	41.00% or greater	0
7,500-7,999	5	39.00-40.99%	3
7,000-7,499	10	35.00-38.99%	6
6,500-6,999	15	31.00-34.99%	9
6,000-6,499	20	27.00-30.99%	12
5,500-5,999	25	23.00-26.99%	15
5,000-5,499	30	19.00-22.99%	18
4,500-4,999	35	15.00-18.99%	21
4,000-4,499	40	11.00-14.99%	24
3,500-3,999	45	7.00-10.99%	27
0-3,499	50	0.00- 6.99%	30

h. Cost of providing municipal services in relation to population (total adjusted expenditures per capita).

Adjusted Expenditures Per Capita	Scoring or Ranking	Percentage Increase in Adjusted Expenditures Per Capita (latest 5 yr pd)	Scoring or Ranking
$0.00-149.99	0	0.00-13.99%	0
150.00-164.99	5	14.00-17.99%	3
165.00-179.99	10	18.00-21.99%	6
180.00-194.99	15	22.00-25.99%	9
195.00-209.99	20	26.00-29.99%	12
210.00-224.99	25	30.00-33.99%	15
225.00-239.99	30	34.00-37.99%	18
240.00-254.99	35	38.00-41.99%	21
255.00-269.99	40	42.00-45.99%	24
270.00-284.99	45	46.00-48.99%	27
285.00 or greater	50	49.00% or greater	30

(8) that any municipality which receives a total scoring or ranking of at least 360 should be deemed to be financially distressed and be eligible for inclusion in at least some of the remedies which comprise the recovery program;

(9) that the determination of financial distress for municipal pension systems should be done annually, that the determination should be made by an agency of Commonwealth government and that the agency charged with the ultimate determination of financial distress should be the Public Employee Retirement Study Commission. The calculation of the scoring or ranking of the actuarial component of the determination procedure should be performed by the Commission and the calculation of the scoring or ranking of the municipal finance component of the determination procedure should be performed by the Commission working in concert with the Department of Community Affairs;

(10) that the procedure for the determination of financial distress should be initiated only upon the election to participate in the program by the governing body of the municipality.

Recovery Program

The Commission recommends the following concerning the remedies to be included in a recovery program for municipal pension systems determined to be financially distressed:

(1) that there be established a recovery program for municipal pension systems determined to be financially distressed in lieu of any other alternative solution to the condition of financial distress in a municipal pension system;

(2) that the recovery program include a variety of remedies for the condition of financial distress in a municipal pension system;

(3) that the remedies in the recovery program include both remedies of a general or at large application and remedies of a specific application;

(4) that the remedies of a general or at large application be a revision of existing revenue sources for pension funding on both the local level and the state level;

(5) that the revision of existing revenue sources for pension funding on the local level be accomplished by ensuring utilization of any omitted or underrepresented local revenue source in the municipalities as a precondition for the use of any other remedy pursuant to the recovery program;

(6) that the revision of existing revenue sources for pension funding on the state level will be accomplished by the establishment of a general municipal pension system state aid program through a restructuring, over a period of years, of the current foreign casualty insurance premium tax aid program and the portion of the current foreign fire insurance premium tax state aid program allocated to pension plans for paid firefighters, with the specifics of the restructuring of the existing state aid programs and the operation of the new general municipal pension system state aid program as follows:

   a. that the general municipal pension system state aid program be financed from total receipts from the foreign casualty insurance premium tax, including any amounts currently payable to the State Employes' Retirement System, and any interest earned on those total receipts, and from the portion of the total receipts from the foreign fire insurance premium tax that would be allocated to pension plans for paid firefighters pursuant to the allocation procedure then in force, including any interest earned on those receipts;

   b. that general municipal pension system state aid program monies be made available to all cities, boroughs, towns and townships;

c. that the general municipal pension system state aid program monies be allocated on a basis related to employer pension costs;

d. that the general municipal pension system state aid program monies be in the form of a non-restricted allocation to offset municipal employer pension costs;

e. that the allocations from the general municipal pension system state aid program be on a per unit basis, with the number of units attributable to each employee in the following categories as follows:

police officers	two units
firefighters	one unit
non-uniformed employees	one unit

f. that the allocations of general municipal pension system aid be determined on the basis of the number of units attributable to each employee participating in existing pension plans, or any revisions to those pension plans applicable to new employees, including the number of units attributable to each employee participating in pension plans established subsequent to the effective date of the proposed legislation after five years from the date of establishment;

g. that the maximum municipal allocation for any municipality be set at 25 percent of the total allocation, with any amount in excess of the limit allocated to all other municipalities on the same allocation basis;

h. that full implementation of the new general municipal pension system state aid program be phased-in over a four year period commencing in 1984, with the following percentages of the applicable receipts of the foreign casualty and foreign fire insurance premium taxes and interest on those receipts to be distributed in each year:

Year	Percentage distributed pursuant to the general municipal pension system state aid program allocation procedure	Percentage distributed pursuant to the current foreign casualty insurance premium tax state aid program and foreign fire insurance premium tax state aid program allocation procedure
1984	25 percent	75 percent
1985	50 percent	50 percent
1986	75 percent	25 percent
1987	100 percent	0 percent

The general municipal pension system state aid will be distributed in September annually;

i. that commencing in 1984 and for each subsequent year in which the supplemental state assistance program and fund are in operation, 30 percent of the gross amount otherwise available for the general municipal pension system state aid program pursuant to the revised allocation procedure, but not more than 60 percent of the amount certified by the Commission as the appropriation for the supplemental state assistance fund, will be deposited in a separate account established for this purpose in the supplemental state assistance fund. The amount to be distributed from this separate account shall augment the supplemental state assistance and shall be allocated to municipal pension systems determined to be financially distressed. The percentage of the total amount of supplemental state assistance, not including the augmentation, which each municipal pension system determined to be financially distressed is certified to receive shall be calculated. Each municipal pension system shall receive an augmentation amount equal to the same percentage of the total augmentation amount available, but commencing in 1988 and for each subsequent year, the amount of augmentation which any municipality shall be eligible to receive shall not exceed 60 percent of the unaugmented, supplemental state assistance amount. Any undistributed amount in the augmentation account shall revert to the general municipal pension system state aid program for distribution. The augmentation to the supplemental state assistance will be distributed with the supplemental state assistance on the first business day in December annually;

j. that the general municipal pension system state aid program allocations to a municipality with a pension fund for paid firefighters be supplemented with an allocation derived from the revenue generated from a one percent surcharge on premiums for foreign fire insurance policies written on properties located in municipalities maintaining pension funds for paid firefighters. The supplemental allocation will be on the basis of the number of paid firefighters employed by each municipality;

(7) that the remedies of a specific application include modifications in the applicable funding standards, the provision of new revenue sources on both the local level and on the state level and the revision of benefit plans to generate a reduction in pension plan cost, and that the remedies of a specific application be structured to match available remedies to degrees of financial distress and to give first priority to specific remedies of local government application and then to specific remedies of state government application. The specific remedies portion of the recovery program would be structured as follows:

a. RECOVERY PROGRAM LEVEL I -

All municipalities with non-distressed employee pension systems and any municipalities with distressed employee pension systems not electing to participate in Level II or Level III will continue to operate the employee pension plans pursuant to current and subsequent statutory provisions, with the option to:

1. Aggregate the various employee pension trust funds into a single pension trust fund.

2. Deviate from any employee contribution limits established pursuant to law or charter to implement revised employee contributions, expressed as a percentage of covered payroll, representing

   (a) not more than 50% of pension plan normal costs in the case of existing pension plans, and

   (b) not less than 30% nor more than 50% of pension plan normal costs in the case of revised pension plans adopted subsequent to the enactment of this proposed legislation.

b. RECOVERY PROGRAM LEVEL II -

Municipalities electing to apply to the Commission for a distress determination subsequently certified as having a distress determination of at least 360 point will be permitted to:

1. Provide municipal funding in excess of any limitations for municipal contributions to employee pension funds contained in state law or home rule charters.

2. Exceed statutorily established limits on earned income and real property taxes provided: (a) that taxes for both revenue sources are currently imposed at the mandated limits, (b) that the revenues derived from any increases in the taxes above statutory limits are dedicated to employee pension funds, and (c) that total municipal contributions to employee pension funds from all revenue sources existing prior to this special taxing authority, expressed as a percentage of covered payroll, are not reduced below the average of the total annual municipal contributions expressed as percentages of payroll, made in calendar years 1980, 1981 and 1982.

3. Defer compliance with the mandated actuarial funding standard by adopting a ten year phase-in period for full compliance. Under the ten year phase-in the required contribution to the municipal pension plan annually would be equal to the contribution made in the previous year plus the

following percentage of the difference between that contribution and the full normal cost and amortization of the unfunded accrued liability contribution for each year during the phase-in:

Year after enactment of Funding Standard	Percentage between prior year's contribution and full requirement
1	10 percent
2	20 percent
3	30 percent
4	40 percent
5	50 percent
6	60 percent
7	70 percent
8	80 percent
9	90 percent
10 and thereafter	100 percent

4. Deviate from any employee contribution limits established pursuant to law or charter to implement revised employee contributions, expressed as a percentage of covered payroll, representing

   (a) not more than 50% of pension plan normal costs in the case of existing pension plans, and

   (b) not less than 30% nor more than 50% of pension plan normal costs in the case of revised pension plans adopted subsequent to the enactment of this proposed legislation.

5. Adopt revised pension plan benefit structures applicable to new employees, regardless of minimum benefits specified in current statutes, provided that the revised pension plans for new employees require employee contributions, expressed as a percentage of covered payroll, representing not less than 30% nor more than 50% of the normal costs of the revised pension plan. The normal cost of the revised pension plan shall be determined initially through an actuarial valuation by applying the benefit plan of the revised pension plan to the covered active population of the prior pension plan.

6. Aggregate trust funds for employee pension plans and, upon certification that employee pension costs are being properly assessed against enterprise funds, federal and state grant funds, and other employers providing employee pension benefits through the municipal pension system, obtain eligibility for allocations of supplemental state assistance.

c. RECOVERY PROGRAM LEVEL III -

Municipalities electing to apply to the Commission for a distress determination and subsequently certified as having a distress determination of at least 500 points are permitted to elect any of the following optional items indicated and are required to implement the following mandated items:

OPTIONAL ITEMS

1. Exercise any of the options available pursuant to Level II; and

2. Defer compliance with the mandated actuarial funding standard by (a) extending the required amortization period for accrued unfunded liabilities to a maximum of 40 years, (b) increasing the phase-in period for full compliance with the actuarial funding standard to a maximum of fifteen (15) years, or (c) both.

MANDATED ITEMS

1. Implement the Level II option providing for the adoption of revised pension plan benefit structures applicable to new employees regardless of minimum benefits specified in current law or charter, but not in excess of the maximum benefits specified in the current law or charter when expressed in terms of the normal cost of the pension plan estimated using the current pension plan membership data, provided that the pension plan for new employees require employee contributions, expressed as a percentage of covered payroll, representing not less than 30%, nor more than 50%, of the normal cost of the revised pension plan.

2. Submit a comprehensive plan for administrative improvements in their municipal pension plans, subject to approval by the Commission, prior to obtaining eligibility for supplemental state assistance.

3. Implement the Level II option providing for the aggregation of employee pension trust funds and, upon certification that employee pension costs are being properly assessed against enterprise funds, federal and state grant funds, and other employers providing employee pension benefits through the municipal pension system, obtain eligibility for allocations of supplemental state assistance.

4. Refrain from any modifications in the benefit plan which would have the result of increasing either the normal cost or prior service cost of the pension plan as determined through an actuarial valuation for the duration of the receipt of supplemental state assistance monies.

d. RECOVERY PROGRAM - SUPPLEMENTAL STATE ASSISTANCE PROGRAM AND FUND

Supplemental state assistance will be provided for municipal pension systems determined to be financially distressed in proportion to the degree of distress. The receipt of supplemental state assistance will be pre-conditioned on compliance with any actuarial funding standard in effect and in accordance with the provisions of the remedial program for municipal pension systems. The allocation of supplemental state assistance will be made pursuant to a formula which does not produce a significant difference between allocations to municipalities with scores immediately above the distress determination point total necessary for eligibility and municipalities with scores immediately below that distress determination level. Allocations to municipalities shall be determined by expressing the municipalities distress determination points in excess of 300 points as a percentage of the maximum distress determination points and applying the resultant percentage to the difference between the current level of financial support for the pension plans in the municipality, excluding any amounts received pursuant to the supplemental state assistance program, and the contributions required pursuant to the actuarial funding standard if fully implemented. An interest bearing supplemental state assistance fund for the program will be established and funded through annual general fund appropriations based on the Commission's certification of the monies needed, not to exceed $35,000,000 in any year. The initial appropriation to the supplemental state assistance fund shall be deposited on the last business day in November 1987, and annually thereafter. The supplemental state assistance fund will be maintained and allocations from the fund will be disbursed, upon certification by the Commission, by the Department of the Auditor General. The authority of the Commission to certify appropriations to the supplemental state assistance fund will expire 15 years after the year in which the initial distribution of assistance from the fund or upon the absence in any year of eligible recipients, whichever occurs earlier. The supplemental state assistance will be distributed on the first business day in December annually.

Emergency loan procedures for municipalities facing imminent default in the payment of pension benefits by one or more of their pension plans will also be established. The allocations previously payable to the State Employes' Retirement

Fund pursuant to the current allocation formula for foreign casualty insurance premium tax proceeds in the period 1984-1987 will be deposited in the supplemental state assistance program fund. Amounts from the fund including the augmentation account shall be made available for disbursement by the Department of the Auditor General upon certification by the Commission as emergency loans to municipalities with acute cash flow problems in meeting employee pension obligations, with repayment of these loans from future allocations of Commonwealth monies pursuant to a plan submitted by the municipality and approved by the Commission;

(8) that the elements of the remedial program be implemented in sequence with the actuarial funding standards initially effective for municipal budgets set in 1984 based on the 1982 actuarial reporting pursuant to Act 293 of 1972, the comprehensive recovery program except for regular allocations pursuant to the supplemental state assistance program effective in 1984, the emergency loan procedure pursuant to the supplemental state assistance program also effective in 1984, the actuarial funding standards fully effective for municipal budgets set in 1985 based on the revised actuarial reporting required pursuant to this proposed legislation and the regular allocations pursuant to the supplemental state assistance program effective in 1987;

(9) that the Commission be instructed within the proposed legislation to recommend the necessary legislation amending existing municipal pension laws to effect consistency of those laws with the provisions of this proposed legislation establishing the municipal pension system remedial program within one year of the enactment of the proposed legislation.