2011 and 2012 MMOs
Investment Losses Will Not Impact PMRS Members

Recently a simple question was asked of PMRS staff: “...with so many pension plans suffering significant investment losses in 2008, the municipalities’ pension obligation will differ considerably from prior years. Is this true for pension plans within PMRS?” We addressed the question not only with the abbreviated answer – NO; but, we also attempted to answer the unasked questions associated with that inquiry. We thought the longer answer would be of interest to our members. Please read on.

Municipal pension plans administered by PMRS will NOT have their 2010, 2011, or 2012 municipal pension obligations (MMOs) impacted by the 2008 investment losses experienced by all pension plans invested in the equity and bond markets. We can make this bold statement because one of the reasons PMRS has been structured the way it has been is so that, by design, we would be able to shield our plans from the market vulnerabilities associated with high market volatility.

We tried to address the big picture problem in our statement to our membership issued on July 23, 2009. (See www.pmrs.state.pa.us.) The economic down turn that started in mid-2008 and dramatically gripped the financial markets in the fourth quarter of 2008 was expected to be seen in Pennsylvania’s municipal pension plans as they prepared their January 1, 2009 Act 205 Actuarial Valuation filings. These valuations, due to be filed no later than the last business day of March, 2010, are in the case of most municipalities (PMRS plans and non-PMRS administered plans) the basis for their 2011 and 2012 MMOs. The reason PMRS plans will NOT see any dramatic change in their MMOs due to the losses experienced in the financial markets is because of the rather unique method PMRS uses to smooth asset fluctuations.

In 1985, the PMRS Board adopted a policy that allows us, to use a favorite PMRS cliché, to tame the roller coaster ride the financial markets offer and to make the ride less scary. PMRS plans were credited with 6% regular interest in 2008, the same as the actuarially assumed investment return. Our success with this process has allowed our enrolled plans to experience more consistent obligations year in and year out.

The process is so successful that early this year the staff of the Pennsylvania Public Employee Retirement Commission (PERC) reached out to our staff at PMRS to see if the process could be adapted to help the non-enrolled PMRS municipal pension plans.

The idea was to collaborate and come up with a way to introduce the asset smoothing technique to the non-PMRS municipal pension world. (Article continued on page 3...)

What’s New?

Act 44 of 2009, signed by Governor Rendell on September 18th, is clearly the newest and most profound piece of news we have to share! However, the information we wish to convey to you is so important and so extensive that it will instead be provided as a Special Edition of the Spotlight posted to the web at www.pmrs.state.pa.us. If you would like a hardcopy of the Special Edition, please contact PMRS and we will provide one to you as soon as the printed version is available.

In addition, the General Assembly and the Governor went one step further and gave local government a new act to discuss – Act 51. This act makes dramatic changes to the Killed in Service “KIS” provisions for all police and fire plans. Check out the news on this law as well at the PMRS website!

The 2009 unit value for State Aid is $3,128.01. Please pay close attention to the accuracy of the information you report to PMRS regarding use and distribution of your State Aid funding as the correctness of this information is essential when completing your financial statements.

Excess Interest

No Excess Interest to be Awarded in 2009

While the news was not unexpected, the System’s consulting actuary, Ken Kent from the firm of Cheiron Inc., did formally share the final results of the 2009 excess interest process with the Board at their September meeting. Cheiron reported that, due to the losses experienced in the PMRS portfolio in late 2008, the January 1, 2008 actuarial surplus of over $106 million dollars had become a deficit of nearly $369 million as of January 1, 2009. Under the adopted Board policy, no excess interest can be awarded in 2009 based upon the System’s 2008 investment return.

Board members took comfort in knowing that the formula for awarding excess interest was working as intended. The surpluses that were built when the System was experiencing better financial markets did help relieve some of the brutal fall-out from the markets’ recent downturn. J. Allen, Secretary of PMRS, expressed confidence in the process, acknowledging that it was working as expected and the plan adopted almost twenty-five years ago once again was proving its value. He said that the Board’s prudence in, “taking a long-term approach to market cycles” has clearly insulated our member plans from the difficulties that so many pension plans were experiencing. He added that this also means that, while the markets appear to be slowly coming back in 2009, PMRS members should not plan on receiving excess interest for several more years. Once the deficit is eliminated and a margin established, the Board will once again be in a position to award excess interest.

For the short-term, J. Allen said that the membership will have to be comfortable with knowing that the Board-adopted regular interest rate of 6.0% will likely hold at that percentage through 2010.
The Pennsylvania Municipal Retirement System is pleased to announce a change in how our Membership Services Division staff is aligned to meet our members’ needs. The change reflects our commitment to providing outstanding service to our customers. It also reflects our commitment to continuously look for ways to improve on that service.

Under the new alignment each municipality has one designated division representative. Each municipality will have one person from Membership Services as their point of contact; one person with whom the municipality can build a positive working relationship. With few exceptions, this representative will be the “go to” person for all of that municipality’s membership services needs. The realignment is based upon the type of municipality in which the member is employed. Please see below:

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<th>Townships</th>
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<td>Cities</td>
<td>Janis Rhodes</td>
<td><a href="mailto:jrhodes@state.pa.us">jrhodes@state.pa.us</a></td>
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All Membership Services transactions and associated questions—enrollments, nomination or change of beneficiaries, estimates, terminations, vesting, retirements, address changes, tax withholding changes, direct deposit, deaths, etc.—should be directed to the appropriate Membership Services contact.

The exceptions to the new alignment are associated with certain types of transactions. Please see the following list as these individuals will be the contacts for the following transactions, regardless of the type of municipality in which the member is enrolled:

- **Domestic Relations Orders**
  - Diane Castner
dcastner@state.pa.us
- **Disability Retirements**
  - Bob Porambo
rporambo@state.pa.us
- **Service Purchases**
- **Portability Transfers**
- **Replacement Checks**
  - Lisa Greene
lsgreene@state.pa.us
- **Certificate of Benefits**

The new reorganization, as outlined above, has already been put into place. Please contact Diane Castner, Membership Services Division Chief, at 717-787-2065 or 800-622-7968 with any comments or issues you have concerning this new approach. We look forward to receiving your feedback.

Please note that this change only affects our members’ interaction with the Membership Services Division. Municipal Contacts should continue to contact the Municipal Services Division on any contract, cost study, upgrade, or actuarial issues. Similarly, PMRS’s Accounting Division remains the contact for all issues pertaining to quarterly reports, MMOs, or financial statements.

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**Redefining our Vocabulary**

Defined Contribution Plans Have a New Name: Cash Balance Plans

Under the story line, “If it walks like a duck and quacks like a duck, it must be a duck,” we have the following news to report. PMRS special counsel has been assisting the PMRS Board and staff in the preparation and filing of paperwork required to confirm PMRS’s tax-qualified status under the federal Internal Revenue Service Code. Based upon the recommendation of special counsel, the Board has agreed to stop referring to our “Defined Contribution” plans as such and, instead, PMRS will begin calling them “Cash Balance” plans. The change in nomenclature is caused by one of the basic advantages to the way the plans, formerly known as “defined contribution” plans, operate.

Because all PMRS plans have a set rate of interest in advance for a given year (our regular interest of 6% in 2009), the plans have what the attorneys and actuaries advise is a “definitely determinable benefit.” While not the typical defined benefit formula, these cash balance plans are not actually defined contribution plans either. To truly be defined contribution plans, the value of a member’s account would have to be related directly to the market’s fluctuations. Simply stated, the plans would have to be credited with the investment loss experienced by PMRS in years that we make less than the regular rate of interest. Since PMRS shields our members’ accounts from these fluctuations, the attorneys believe that the I.R.S. will classify them as cash balance plans.

What does this mean going forward? In terms of how the plans operate, the only change that we will have to make is that, in the future, these plans’ agreements will have to be amended to eliminate the provision that allows for the reallocation of a former member’s forfeited account among the remaining active members of the plan. The I.R.S. Code prohibits such a provision. Other than that, the plans will continue to be structured as they currently are and the members’ accounts will continue to be insulated from market fluctuations. The System has been advised by the Public Employee Retirement Commission (PERC) that these plans should still continue to file the “Type A” Act 205 Valuation Reports.

So, other than an upcoming request to amend the plan documents to eliminate the forfeiture reallocation provisions, the defined contribution plans will simply be undergoing a name change. They will now be referred to as “cash balance” plans. Municipalities having adopted these types of plans will be hearing more about this change in the coming months. The attorneys are developing a new plan document template which we plan to start rolling out in the next four to six months. •
That effort has resulted in the passage of Act 44 signed into law on September 18, 2009. The legislation conceptually duplicates PMRS’s asset smoothing approach. If used by municipalities as it is offered—as an option, not a mandate—it is expected to delay the full impact of the financial losses on most municipal pension plans for at least two or three years. The hope is that within this time frame the markets will come back strongly enough so that the pain will not be as insufferable when their 2011 Valuation is prepared.

The good news is that, if municipal pension plans stuck with the long term approach to investing and the principles of reducing risk by way of asset diversification, they will be experiencing some of that market recovery already. PMRS learned at their September Board meeting that the System’s portfolio return, year-to-date, is over 12%. While that figure does not completely offset the 2008 losses, it does confirm that PMRS has been able to smooth out our members’ MMO fluctuations by carefully and prudently taking the long-term approach to investment management.

We don’t want to mislead our members. Even with no investment losses, the 2009 Valuation will likely be different from the 2007 results. A number of other factors can produce actuarial gains or losses which will affect a pension plan’s funding status. In plans with an actuarial surplus, actuarial gains will increase the surplus, therefore increasing the 10% credit that must be taken each year in determining the MMO. Actuarial losses will reduce the actuarial surplus. If the plan has an unfunded liability, that liability is amortized and typically must be paid off over a time period that ranges from 10 to 30 years, depending on the event that caused the liability as well as the remaining expected working years of the plan membership. Actuarial gains will reduce the unfunded liability, therefore reducing the annual amortization payments. Actuarial losses will increase the unfunded liability as well as the annual amortization payments.

- **Benefit improvements**—Any benefit improvements that were made to the plan between January 1, 2007, and January 1, 2009, will typically result in an actuarial loss.
- **Investment gains**—Any excess interest that was credited to the plans’ municipal accounts on December 31, 2007, will create an actuarial gain on the January 1, 2009 Valuation.
- **Salary increases**—One of the actuarial assumptions that is made in determining the plan’s funding requirements is how much salaries will increase each year. If salaries increased less than what was assumed, this would create an actuarial gain. If salaries increased more than assumed, this would create an actuarial loss.
- **Turnover**—Another actuarial assumption relates to the turnover over rates. If more employees terminated employment prior to reaching eligibility for vesting or retirement than what was assumed, this will create an actuarial gain. If there was less turnover than assumed, there would be an actuarial loss.
- **Early retirements**—If any employees retired prior to when it was assumed they would retire (employees are not necessarily assumed to retire as soon as they are eligible), this would create an actuarial loss.
- **Service purchases**—Member purchases of prior service or military service typically create actuarial losses.
- **Use of Surplus Credits**—For the plans that had actuarial surpluses in their 2007 actuarial valuation, it is likely that the plans’ over-funded status will significantly decrease by design. State law gives municipalities the authority to use 10% of a plan’s actuarial surplus to “pay,” or offset, a plan’s MMO in the two years following the valuation showing a surplus. This means that the next actuarial valuation’s surplus will be a little bit more than 20% less as a result of using a portion of the previous surplus to meet a portion of those next two years’ MMOs. This means that the 10% credit of the surplus will be 20% less as well.

When will our members know for sure? PMRS is on track to share the results of the January 1, 2009 Valuation very early in 2010. Work is well underway and already we are months ahead of where we and our actuaries have ever been historically. Despite the growth in the number of plans for which we have to develop valuations and the number of enrolled members PMRS serves, the improvements in internal processes and the dedication of key resources and people to the effort are producing promising results. We look forward to sharing the numbers earlier than they have ever been provided in the past. A note of appreciation also goes out to our municipal contacts and the staff at our member municipalities. The ability for us to prepare the valuations starts with the completeness of the data we received from our contacts and the timeliness of the delivery of the same.

As our contacts know, the automation of and computerization of a number of key steps in the PMRS service delivery system helped us to provide more timely financial statements for 2008 than have ever been produced in the past. We are very excited to translate your cooperation into more timely and accurate data. We are committed to building on this improving track record by the earliest delivery of the Act 205 valuations ever. ✴
October 12 – Holiday: Columbus Day – Office closed

October 29
Retiree checks mailed from PMRS. (Directly deposited pension payments deposited to retirees’ accounts on October 30.)

November 2
Deadline for returning the Quarterly Reports for the 3rd Quarter to PMRS.

November 11 – Holiday: Veterans Day – Office closed

November 19
Pennsylvania Municipal Retirement Board Meeting.

November 25
Retiree checks mailed from PMRS. (Directly deposited pension payments deposited to retirees’ accounts on November 30.)

November 26 & 27 – Holiday: Thanksgiving – Office closed

December 15
PMRS deadline for municipalities to pay current year MMO to insure the payment is properly credited to plan’s account in the current year. Note: The legal deadline for payment is December 31.

December 21
Quarterly Reports for the 4th Quarter mailed to municipalities.

December 25 – Holiday: Christmas – Office closed

December 30
Retiree checks mailed from PMRS. (Directly deposited pension payments deposited to retirees’ accounts on December 31.)

December 30
Next year’s pension bill based on MMO prepared in September mailed from PMRS.

January 1
Unpaid MMO now delinquent; must pay interest from January 1 of the previous year.

In The Know

Q. My municipality opted to participate in the trial run of PMRS’s new online quarterly report system. When is PMRS going to start testing this system?

A. PMRS has received a number of responses from municipalities wanting to participate in the testing phase of the proposed online quarterly reporting system. Preparation is underway to “go live” with the trial of this initiative. As such, we are no longer accepting applications to participate in the control group for the test run. Those individuals/plans which have been accepted as part of the control group will be notified as soon as PMRS is ready to begin testing this process. PMRS staff would like to thank you for your participation and your patience.

Questions for “In the Know” can be e-mailed to PMRS at “ra-staff@state.pa.us” (please insert in the Subject line: “In the Know”) or they can be sent to:

In the Know column
C/o PMRS
P.O. Box 1165
Harrisburg, PA 17108-1165

If your municipality’s PMRS contact person has changed, please contact PMRS and provide us with the new contact person’s name and e-mail address. If your municipality has changed its address or phone number, please let us know.