PENSION ADVISORY BOARD/HEALTH & WELFARE BOARD OF TRUSTEES
MAY 14, 2014
QUARTERLY MEETING

The Pension Advisory Board/Health & Welfare Board of Trustees, met for their Quarterly Meeting on Wednesday, May 14, 2014, in the Township Building. The meeting was called to order at 5:30 p.m. followed by a pledge to the flag.

ROLL CALL:

The following members of the Pension Advisory Board/Health & Welfare Board of Trustees were present: Greg Waks, Supervisor Liaison/Trustee; Eric Medrow, Chairperson; David G. Kraynik, Vice Chairperson; Chief Tom Nolan, Secretary. Others present were: Sudha Suryadevara, Non-Uniformed Representative; Sgt. Andrew Andreyko, Police Representative; Sara Evans, HR Director; Nick Hiriak, Finance Director; James P. Kennedy, President, Thomas J. Anderson & Associates and Douglas Werley, Consultant, Thomas J. Anderson & Associates, Randee W. Sekol, Chief Actuary, Beyer-Barber Company.

MEETING MINUTES:

It was moved by Mr. Kraynik, seconded by Chief Nolan, all voting "Aye" to approve the March 12, 2014 Meeting Minutes as submitted. None opposed. Motion approved 4-0.

PRESENTATION BY ANDERSON & ASSOCIATES

Mr. James Kennedy, President, Thomas J. Anderson & Associates stated their firm has been handling Upper Merion's pension consulting services for close to 20 years. He noted they handle multiple municipalities with over 200 plans and are considered one of the leaders in the state. Douglas Werley has been with the firm a number of years and served previously in the Auditor General's office auditing pensions throughout the state. Randee Sekol is head of Beyer-Barber Company and handles all of the actuarial work. He is one of the largest actuaries and very highly experienced in municipal pensions throughout the state.

Mr. Kennedy indicated his firm is the "nuts and bolts" talking to the management team in the municipalities on a daily, weekly basis and handle everything from benefit calculations and employee rosters for both retirees and active members. They facilitate all the forms dealing with pensions in terms of state filings, MMO's, state aid calculations, deposits, oversee the bi-annual process with the actuarial recording, support for staff with pension questions, calculation issues, ordinances, or provide presentations for meetings. The firm is focused on pensions and is not involved whatsoever with investments or banking.

Mr. Kennedy noted there are a lot of issues and challenges out there, but many municipalities at the grass roots level are doing some really smart things. They have decent investment returns recently and are making decisions about benefits and changing structures such as moving from smoothing to market value assets.

Mr. Kennedy provided some statistics obtained from the Auditor General's February report. Based on the 2011 actuarial data, of 1,200 municipalities, 573 (or 50%) are classified as distressed. Mr. Kennedy explained anywhere from 90% funded and up is zero distress, 70% and 89% is minimal, 50%-69% moderate and below 50% is severe.

There are some municipalities really struggling because of poor investment returns that got hit, basically paying minimums for years and years, and having benefits they cannot afford. There is approximately $6.7 billion unfunded around the state. Excluding Philadelphia and Pittsburgh, there is $1.6 billion unfunded.

Mr. Kennedy discussed the assumed rate of returns in the plans. The study referred to 7% and 8% which is the assumed return actuaries use for what the market is going to generate for the plan over two years. The theory is with 8% you have to earn 16% in two years. These percentages were set years ago when investment returns were higher. They are lower in today's market plan and it could be a challenge to hit 16% over two years. The bulk of the plans are in the 7%-8% range.

Mr. Medrow asked if the 8% includes both the equity and the fixed side. Mr. Kennedy responded in the affirmative and said it is holistic in looking at the plan return.

Mr. Medrow commented the fixed side may be pulling the 8% down somewhat. Mr. Kennedy indicated that is correct and said fixed income has been "tough sledding" recently.

Mr. Kennedy noted 2013 was a very positive year with equities and the general plan doing well. The Upper Merion Police Pension Plan was in the top tier of the ones that have been earning 18-19%. While his firm does not get involved in investments or in the selections, they see it when they prepare the financials and look at it on a historical basis. The average that they see is in the mid to lower teens. Some in the high single digits have been very conservative, but the average is below 15%.

Mr. Kennedy said a couple of things are going on to adjust to these rough times. Some municipalities are taking a look at some of the benefits they have historically had and can no longer afford and they are having new hires coming in after a certain period of time at a different benefit structure. They are also increasing the retirement age as well as eliminating some optional benefits. With regard to non-uniformed, they are seeing a movement to defined contribution plans which are similar to 401-k's which eliminates the defined benefit risk from the municipality as Upper Merion did back in 1990. Another trend they see happening is people are being asked to pay more across the board for both health care and member contributions. Also, the mortality tables have been updated. This was taken into account in changing the assumptions across the board for almost all of their clients on the 1/1/13 valuation.

Mr. Medrow asked for an explanation of 1/1/13. Mr. Kennedy responded 1/1/13 is the valuation date when the Act 205 actuarial valuations are done. It is a key municipal event occurring every two years and is a balance sheet status of the plan which looks at what the liabilities are based on, plan benefits, assumptions of how long people are living, salary increases, investment return assumptions, and it looks at plan assets to determine if there are enough assets to pay the liabilities. The 205 report attempts to ensure that the municipalities are constantly funding the plans correctly going into the future so they are paying enough for the liabilities.

Mr. Kennedy discussed the key pension events occurring every year. He pointed out in the beginning of the year financial statements are done for the previous year. In the March/April time frame the AG-385 state aid certification form must be completed. This document has police, fire and non-uniformed all on one form and includes payroll data, and the number of employees that qualify for state aid. Coming into the summer months, payroll data is collected for the current year so they can begin to prepare the Minimum Municipal Obligation which is due in the fall and has to be paid every year by December 31st. If it is not paid there is a punitive penalty which is at the assumed investment rate of the plan.

Mr. Medrow asked for an explanation of the Act 205 requirements. Mr. Kennedy responded the 205 valuation takes into account the previous two years of data, market returns, plan dynamics, and rosters of active employees. Mr. Sekol noted Act 205 sets the minimum funding standards the municipality must contribute into the plan. The actuarial valuations are done to determine how much money the township has to put into the police pension plan. Census data and asset information is obtained from Anderson & Associates.

Mr. Medrow asked for clarification of who does what at the two firms. Mr. Kennedy responded Randee Sekol is the actuarial firm and Anderson & Associates are the pension administration consultants.

Mr. Medrow questioned why the duties are split with Anderson & Associates as the pension administrator consultant and Beyer-Barber as the actuary. He asked if it is not typically a standard procedure that both of those functions are in one organization. Mr. Kennedy responded it varies across the board and it is a choice. He said Beyer-Barber was selected since they are one of the most experienced actuaries in the state. Mr. Kennedy explained Beyer-Barber is a facilitator for Anderson & Associates who are the Township's primary point of contact. For example, Anderson & Associates work with Beyer-Barber to complete required filings on time and they do the actuarial work. Coordination is required with regard to rosters, assumptions, etc.

Mr. Medrow said he is trying to see how everyone fits together. He mentioned D. F. Dent is responsible for investing the funds, but he has to invest the funds in such a way that he knows what kind of benefits will come due in any particular year so that the portfolio is managed in such a way that cash is available for that purpose.

Mr. Medrow asked if Anderson & Associates communicates with D. F. Dent. Mr. Kennedy responded they typically do not with the majority of investment advisers and do not direct them on how to manage their portfolio. Collectively with the municipality, communication could occur on actuarial assumptions or issues where there is a need to impact what is being done. He said Anderson & Associates communicates with Beyer-Barber on a daily basis. Mr. Kennedy also noted if the municipality would ever want to change or improve a benefit in the plan as part of negotiations; Anderson & Associates would have to be involved because under the rules you are not allowed to improve those benefits without doing a cost study.

Mr. Medrow asked how D. F. Dent communicates their needs in terms of developing cash. Mr. Dent responded he knows what their monthly participant beneficiary distributions are and they make sure the cash available.

Mr. Medrow asked if a report is sent to D. F. Dent. Mrs. Evans responded it is obtained in house from the payroll department. Mr. Medrow asked how the actuary figures into this. Mr. Sekol responded the payroll department provides the information to Anderson and Associates since they are the collector of data, assets, do the forms and filings. Anderson & Associates provides the census data and asset information to Beyer-Barber who does the cost. Ms. Evans at the same time is sharing with D. F. Dent what the payouts are and they are sharing with Beyer-Barber not only what is invested which is important for selecting an interest rate, but also the data, assets, and plan provisions that are changed so Beyer-Barber can properly determine the cost.

Mr. Medrow indicated he wanted to make sure there is communication among the payroll department, Anderson & Associates and D. F. Dent. Mr. Kennedy mentioned Anderson & Associates has to have a roster of active and retired employees in order to do all the state forms and filings. They have very detailed spread sheets showing everyone's payroll, member contributions, hire dates, retirement dates, and pension calculations. It is important to keep informed and current about hire dates and terminations so the state forms and filings will be accurate, and it is very important to have interaction on a very regular basis.

Sgt. Andreyko asked if the goal of the MMO is to try to get it to zero stress level. Det. Geckle asked if there are different levels being fully funded. He noted technically the police pension fund is fully funded, but not fully funded to the point where the 20-year benefit could be provided. Mr. Kennedy responded MMO's are paid every year and at a smooth funding value the pension fund is at 97% currently. The way this state looks at funding is not for an individual plan. It looks at it at a municipal level considering the non-uniform and police plan. With the non-uniformed plan being defined contribution it is a very straightforward entity.

Mr. Medrow commented he thought Anderson & Associates just took care of the defined benefit plan. Mr. Kennedy responded his firm oversees the roster; they do not manage.

Mr. Medrow asked what type of actuarial work is required under defined contribution plans. Mr. Kennedy responded it is basically the same analysis covering rosters, employees, and financials.

Mr. Kennedy discussed smoothing and noted the Upper Merion plan on smooth is 97%. He explained smoothing is a practice that has been in place for a long time. When the markets took a hit in 2008 a lot of pensions lost anywhere from 30 to 40% in value. Upper Merion's plan was down approximately 19% which was a moderate loss relative to many of the other municipalities. The loss was $7 million. The MMO in that year after would have gone up by almost $1 million instead it went up by a fractional portion because of the shift to smoothing. Mr. Kennedy noted he does not favor smoothing because it is moving the problem down the road and at a state level they have always advised to pay market value as much as possible. However, in the realities of those economic times most municipalities did not have the discretionary option to pay the full market value of the plans. The idea of smoothing is to try to make up that difference going out over time similar to paying off a loan. In looking at the police plan on a market value basis to compare the numbers, the plan now has a funding gap of $6 million and with 87% funded it is at a level 1 distress in looking at it from a market standpoint versus a smooth. Mr. Kennedy said he favoring discussing the plan from a market standpoint because that is the reality of the actual plan assets.

Mr. Kennedy advised even if the Township is paying a Minimum Municipal Obligation that is on smooth to try to pay more and attempt in the next valuation, where possible budget wise, to shift back to being market value.

Mr. Kennedy noted the good news in looking holistically at the state whether the plan is at 87% or 97% it is a strong plan compared with some of the other municipalities who are at 40% - 60%.

Mr. Kennedy pointed out the risk of ramping up benefits when all is going well. He said one of the biggest costs to a pension plan are disabilities and having employees go out early in their career.

Mr. Medrow asked how municipalities plan for such a possible eventuality. Mr. Sekol responded they use actuarial assumptions to account for disability and he described the process. With a population of 56 people disability rates are pretty low, for example ½% a year and they would project .3 of a person will become disabled and start funding for his benefits a lot earlier than when it would have started at normal retirement.

Mr. Medrow questioned how Mr. Sekol comes up with that figure. Mr. Sekol responded there are mortality, disability, retirement and turnover tables. Mr. Medrow said there are different disability factors for police officers than for the general population and there could be a tragedy that occurs in a particular police department. Mr. Sekol responded such occurrences cannot be anticipated, but they are planned for to a certain extent as previously mentioned.

Mr. Kennedy posited what would happen, for example, if one of those tragedies occurred this year and three officers or three firefighters went out on disability early in their careers before an actuarial valuation. The 1/1/15 valuation report would reflect an actuarial loss because it is factoring in all of the extra payments that have to be made and spread out like a loan over a number of years. For example if the component is $100,000 divided over 10 years, that component is going to go into the MMO each year to pay that off.

Det. Geckle said it is his understanding that the state provides insurance for that now and the Township previously had an insurance policy with the Pension Fund as the beneficiary. Mr. Kennedy responded are certain transitional issues related to implementing the Act 51 [Killed-in-Service benefit]. While Act 51 provides that it become effective immediately, this is not true for police officers who are covered by a collective bargaining agreement. He pointed out Upper Merion still has the old "killed in service" language in the police contract and this needs to be updated for the officers. If there is any insurance that is being carried, once Act 51 is in place, significant savings should be realized. The state would then pick up the benefit rather than the municipality.

Mr. Medrow asked if the insurance policy is still in effect. Det. Geckle responded he was informed by the prior HR director that the township no longer needed to carry that policy because the state took it over.

Mr. Medrow and Det. Geckle questioned whether the insurance policy is still valid. Mr. Kennedy responded he does not know if the Township does or does not have the insurance; however, the Township does not have the Act 51 language in any of the documentation he has seen. He recommended having the officers negotiate that as an amendment to the contract and incorporate the new language in an ordinance/resolution to transition into Act 51.

Mr. Medrow asked if the state provides this benefit at no cost to the municipality. Det. Geckle responded in the affirmative. Mr. Kraynik stated the Act 51 legislation was enacted in 2009, and he and the HR Director will look into what their predecessors did about the Act 51 issue and follow up on the matter.

A discussion followed during which members of the group asked questions about the Killed-in-Service benefit and actions which must be taken now going forward to protect the interests of the police officers.

Mr. Kennedy resumed his discussion about funding and wanted to emphasize that at 87%-97% holistically the Township is at very good levels, but he does not want to see it drop and by the 1/1/15 valuation would like to see movement from smoothing into market.

Mr. Medrow asked for a brief description of what is meant by "asset smoothing." Mr. Kennedy responded when there is a loss in a plan asset smoothing through a lot of mechanics pumps you back up artificially so that payments are smoothed out over a number of years. Mr. Sekol used the analogy of having electric heat in your home. If it is a cold month the bill is up at a certain level, and if it is a warm month the bill is down at another level. He said this is not desirable for a pension plan, and you need to have some sense that your budget is going to be relatively level so there is no surprise suddenly if the MMO is up $500,000.

Mr. Medrow asked if asset smoothing has been done since the market drop. Mr. Kennedy responded the Township agreed to shift to smoothing in 2011 because of the budget implications.

Mr. Waks asked about the approximate difference now. Mr. Sekol responded the smooth assets are approximately 13% higher than the market value of assets, but that has been narrowing. In 2009 it was 20% and it has been coming down over time.

Mr. Waks asked about the raw number. Mr. Kennedy responded $6 million underfunded as of 1/1/13 at market value. Mr. Sekol asked what the unfunded figure was at smoothing. Mr. Kennedy responded it is $1.3 million and change.

Mr. Medrow asked if the 97% is without asset smoothing. Mr. Kennedy responded it is 97% with smoothing and 87% without smoothing. He pointed out the 97% is for the municipality as a whole and the non-uniformed side helps because it does not have the actuarial loss and is a steady constant.

Mr. Medrow asked Mr. Kennedy to go over the questions forwarded to Anderson & Associates prior to this meeting. Mr. Kennedy indicated most of the questions were answered during this discussion and went over the specific questions.

1. Who sets the actuarial assumptions?

   RESPONSE: Actuarial assumptions are set in discussions with the municipality

   Mr. Fogley asked if the assumption of 8% is on an average annual basis or compounded basis. Mr. Kennedy responded compounded basis.

   Mr. Kraynik asked if the actuarial assumption for most of their municipal clients is in the 8% range. Mr. Kennedy responded in the affirmative and said it was common. Mr. Medrow asked if 7% would be a more realistic number. Mr. Kennedy responded while it would he explained that a quarter point movement is significant impact to the MMO and if the budget dollars are there he would prefer to see the Township get off smoothing and onto market value by 1/1/15 and then start trying to get the assumption down. He pointed out the reality is a cost study has to be done to make that change to see what the impact is.

2. Was there an actuarial study done at the time the social security offset provision was added to the plan?

   RESPONSE: Yes, a study was prepared as of January 1, 2008 assuming that the offset would continue for all future years. The elimination of the offset for retirement dates on and after 12/31/2023 was not part of that study.

   Mr. Medrow asked who made the decision to eliminate the offset.
   Mr. Sekol responded it is in the collective bargaining agreement.

3. Is the current member contribution rate in accordance with Act 600 given the 75% social security offset?

   RESPONSE: It is in accordance with the CBA.

4. Who determined that asset smoothing should be used?
   RESPONSE: Asset smoothing was passed by law to help municipalities manage significant market loses and their municipal obligations. Smoothing like other actuarial assumptions were set in discussions with the municipality.

5. Please explain asset smoothing and what accounts for the difference between the market and actuarial value of assets.

   RESPONSE: The smoothing method starts with the actuarial value of assets used in the prior valuation and rolls forward the assets using actual contributions into the plan and non-investment disbursements out of the plan. It also credits interest on the assets at a rate of 1% less than the assumed rate. After rolling forward the assets for two years using these items, this value cannot be above 120% of the market value of assets nor below the market value of assets. Therefore, the difference between market and actuarial value of assets is due to asset returns which are different from 1% less than the assumed rate or the fact that the smoothed value may have been capped at 120% of market value. This method is the same method used by the Pennsylvania Municipal Retirement System.

6. Are the plan liabilities stated in the 1/1/2013 Act 205 report reduced by the social security offset?

   RESPONSE: No. The social security offset only applies to officers hired on or after 10/22/97 and is eliminated for retirements on or after 12/31/2023. An analysis of the data shows that there are very few actives who have a date of hire on or after 10/22/97 and a normal retirement date before 12/31/2023 (the date after which the offset is eliminated). Therefore, the actuary made the assumption that these participants will wait a couple of additional months to retire after the date the offset is eliminated to enhance their benefit. Therefore, the actuary did not value the social security offset and are funding for the full benefit.

Mr. Fogley asked additional question about question #3 above, and a discussion followed about the last state pension audit for 2008 through 2010. Mr. Kennedy responded there were no audit findings on this [offset]. He noted while two or three audit reports indicated there were excess benefits, because of his firm's diligence corresponding back and forth the findings were rescinded. Mr. Kennedy indicated the Township has a clean audit report for 2008 and 2010 which is posted online on the Auditor General's website.

7. Can you estimate the funding status of the plan under the following scenarios:

RESPONSE:

a. If asset smoothing was not used – The Unfunded Accrued Liability of the Plan would increase from $1,336,934 to $6,028,090 and the 1/1/2013 municipality's net cost would increase by $549,568.
b. If the social security offset had not been implemented – The valuation results would not change as explained in the answer to #6 above.
c. The interest assumption was reduced to 7.75% - This would require an actuarial study.

8. Can you discuss the 2023/2024 funding implication of having the social security offset removed at that time?

   RESPONSE: As explained in #6 above, there is no funding implication.

Mr. Kraynik indicated representatives from ICMA-RC will be responding to questions about the Non-Uniformed Pension plan at the next Pension Advisory Board meeting.

Mr. Medrow emphasized the fiduciary responsibility the Pension Advisory Board has and indicated Anderson & Associates and Beyer-Barber will be invited to return from time to time as issues develop and explanations are necessary. Mr. Kennedy indicated it is imperative that the Pension Advisory Board meet on a fairly regular basis with Anderson & Associates, Beyer-Barber, and D. F. Dent. He reiterated the Township should pay as much as possible on the minimum obligation and he would like to see the Township move toward market value on the 1/1/15 valuation.

A member of the group asked for clarification about the language in the Township's DROP ordinance. Mr. Kennedy replied he was not involved with that particular ordinance and was not given a copy of the DROP ordinance. He indicated he would want to look at that before responding.

A discussion followed about the ambiguity of the language in the DROP ordinance and the need to clarify.

Mr. Kennedy emphasized the importance of proactive communication during negotiations, drafting ordinances, or considering benefit enhancements so that a cost study could be provided beforehand. Otherwise, the township would either get hit on the next actuarial valuation or end up with an ordinance that no one understands.

Mr. Kraynik indicated this matter will be addressed at a workshop meeting and it would be necessary to see if there is something under collective bargaining that has to be done.

With regard to the DROP ordinance situation, Mr. Werley suggested waiting until the audit report for this year is issued. In this way besides the known issues that have to be cleaned up it would be better to see if there are any other matters to be addressed as a result of the audit. Det. Geckle agreed except for the Act 51 which should be done as soon as possible.

Mr. Kennedy indicated he had a sample ordinance ready to go and would be pleased to provide assistance.

Sgt. Andreyko asked if there is a third party providing assurances that the vesting calculations are correct. Mr. Kennedy explained the process which is initiated by the municipality, exchange of data, and checks and balances that occur between the municipality and Anderson & Associates when someone retires.

Mr. Fogley asked who does the calculations. Mr. Kennedy responded the calculations are done in his office. They have a very careful double check system in place where two people independently do the calculations, pull it together and see if there are any differences. In the case of ordinance language two of them would look at the ordinance and if there is some lack of clarity they look to historical precedent so two people at all times are signing off and reviewing the calculations and documents.

Mr. Dent asked if any information is available on what the 1/1/14 unfunded liability is on the market. Mr. Sekol responded they only do a valuation every other year in the odd year so they are not looking at it in 2014. He said they could do a valuation, but it cannot be used for any purpose under Act 205.

Mr. Waks asked about the value of the funds now as compared to 1/1/13. Mr. Dent responded it is approximately $44 million as opposed to $40 million. Mr. Kennedy noted the gap between market and smooth has narrowed from $900,000 to $500,000 and he would like to see that continue.

Sgt. Geckle asked if it is reasonable to try to go market based on 1/1/15. Mr. Kennedy responded it depends on the budget and how it works out with the funds.

Mr. Dent commented what we are looking at 1/1/14 versus 1/1/13 is $44 million in round numbers versus $40 million. He pointed there is an increase of $4 million after paying out during the course of the year a little over $2 million in benefits. Prior to payment of benefits there were $6 million in investment returns so the gap [between market and smooth] should narrow.

ADDITIONAL BUSINESS

None.

ADJOURNMENT

It was moved by Sgt. Andreyko, seconded by Chief Nolan, all voting "Aye" to adjourn the meeting at 7 p.m. None opposed. Motion approved 4-0.

David G. Kraynik
Township Manager and Vice Chairman

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Minutes Approved:
Minutes Entered: