

**PUBLIC EMPLOYEE  
RETIREMENT COMMISSION**

**ADVISORY NOTE**

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|------------------------|----------------|
| <b>Date Prepared:</b>  | June 18, 2003  |
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**House Bill Number 812, Printer's Number 947**

**Prime Sponsor:** Representative James E. Casorio, Jr.

**Committee:** House Local Government Committee

**Retirement Systems Affected:** Municipal Police Pension Law (Act 600 of 1955)

**Subject:** Benefit Enhancements

**SYNOPSIS**

House Bill Number 812, Printer's Number 947, would amend the Municipal Police Pension Law (Act 600 of 1955) to:

Increase the permitted survivor's benefit from 50 percent to 60 percent of the pension the deceased, retired member is receiving when the member dies or the deceased member would have been receiving had the member been retired at the time the deceased member dies;

Reduce the minimum time period over which a member's final average salary is computed for purposes of computing the member's pension from the last 36 months to 24 months of employment;

Increase the maximum length-of-service increment for service in excess of 25 years that may be paid to a retiree in addition to the basic pension from \$100 a month to \$600; and

Increase the limit on cost-of-living adjustments that may be paid to a retiree so that the total cost-of-living adjustment plus the pension cannot exceed 80 percent of the retiree's final average salary rather than the current 75 percent.

**DISCUSSION**

**Municipal Police Pension Law**

The Municipal Police Pension Law (Law) governs the establishment of police officers' retirement systems in every borough, town, or township with three or more full-time police officers and in every

**DISCUSSION (CONT'D)**

regional police department (municipality). At its option, a municipality with fewer than three full-time police officers also may establish a police officers' retirement system under the Law. As of January 1, 2001, there were at least 621 municipal police officers' retirement systems with three or more members operating under the Law. In addition, there also were some one- and two-officer systems that were operating under the Law. The 621 systems covered 7,561 active municipal police officers.

**Survivor's Benefit**

Currently under the Law, if a retired police officer or an active police officer eligible for a pension dies, the officer's surviving spouse is entitled to a survivor pension equal to 50 percent of the pension the deceased officer was receiving or would have been receiving had the deceased officer been retired when the officer died. The survivor's pension is payable during the surviving spouse's lifetime. If the spouse does not survive or survives and subsequently dies, the survivor's pension is payable to any child or children younger than the age of 18, or if the child is attending college, age 23. The bill would increase the mandated survivor's pension from 50 percent to 60 percent of the deceased officer's pension. Because the survivor's benefit is a stand-alone benefit rather than an optional form of the member's single-life annuity, the proposed increase in the survivor's benefit would increase the existing disparity between the actuarial value of the benefits provided to retiring members with surviving spouses and to retiring members without surviving spouses. The Commission's consulting actuary has estimated that this change in the minimum survivor's benefit would result in an increase in aggregate actuarial accrued liabilities of between \$14,600,000 and \$16,300,000.

**Final Average Salary**

Currently under the Law, a police officer may retire after a total of 25 years of service with the same municipality when the officer reaches age 55. If an actuarial valuation shows that it is feasible, this age may be reduced to 50. The monthly pension, other than length-of-service increments and cost-of-living adjustments, is equal to one-half of the monthly salary of the officer averaged over the last 36 to 60 months of employment. The bill would reduce the minimum time period over which the final average salary is computed from the last 36 months to the last 24 months of employment.

For most police officers, reducing the period over which their final average salaries are computed to their last two years of employment will tend to increase their pensions because their compensation tends to increase over their working lifetimes. The reduction can work to the disadvantage of officers whose last two years, for whatever reason, are not as highly compensated as some of their earlier years of service, and the reduction would make manipulation of the final average salary through overtime compensation easier. The Commission's consulting actuary has estimated that this benefit

**DISCUSSION (CONT'D)**

change would result in an increase in aggregate actuarial accrued liabilities of between \$29,000,000 and \$32,300,000.

**Length-of-Service Increment**

Currently under the Law, in addition to the monthly pension or retirement allowance, the municipality may pay a length-of-service increment to a retired police officer for each completed year of service beyond 25 years. The maximum length-of-service increment is \$100 a month. The bill would increase the maximum length-of-service increment from \$100 a month to \$600 a month.

As was typical at the time of its enactment, the pension plans under the Law resemble pension plans for military personnel with half-pay pensions after 25 years of service. This “fixed benefit” approach differs from the usual defined benefit pension plan in which the pension benefits vary based on the product of the years of service multiplied by a benefit accrual rate. Under an historic “fixed benefit” police officers’ pension plan, there is a disincentive to remain in public service after completing the minimum service (25 years in this case), while there is an appropriate incentive for remaining in service longer under a conventional “variable benefit” approach. In Act 40 of 1973, the Law was amended to permit the current length-of-service increments, which were intended to be granted as a given dollar amount per month for each year of service beyond 25 years, not exceeding \$100 a month in total. The result was that skilled police officers had a retirement-related incentive to continue service beyond 25 years. To ensure that the provisions for length-of-service increments in the Law serve the intended purpose, the language should provide that the increment for each year of service beyond 25 years be no more than \$100 per month and that the length-of-service increments total no more than \$600 per month.

When provisions for the length-of-service increments were added to the Law, they were limited to a total of no more than \$100 a month. Inherent in any named dollar limit is the erosion of the purchasing power over a long period of time. As a result of the change in purchasing power, the length-of-service increment benefits have become relatively less valuable because of the \$100 a month limit. The Commission’s consulting actuary has estimated that this benefit change would result in an increase in aggregate actuarial accrued liabilities of between \$14,000,000 and \$14,500,000.

**COLA Limitation**

Currently under the Law, a municipality may provide for a cost-of-living allowance (COLA) for its retired police officers. The COLA cannot exceed the percentage increase in the Consumer Price Index from the year in which the retired police officer retired and cannot cause the total pension to exceed 75 percent of the final average salary used for computing the retiree’s retirement benefits. Also, the total COLAs may not exceed 30 percent. The bill would increase the salary-related limit on COLAs from 75 percent to 80 percent. The total COLAs still would be limited to 30 percent. The

**DISCUSSION (CONT'D)**

Commission’s consulting actuary has estimated the costs associated with this benefit change would be negligible because it is the 30% limit that currently serves to cap the COLAs provided to members. However, if the length-of-service limit is increased as proposed in the bill, this benefit change would increase the likelihood that some retired members would have their cost-of-living adjustments capped at a higher level due to the increased percentage of salary limit, because the limit on the total cost-of-living increases of 30% would be less likely to be applicable.

**SUMMARY OF ACTUARIAL COST IMPACT**

The Commission’s consulting actuary has reviewed the bill and determined that the increase in survivors’ benefits, the reduction in time period used to compute final average salary, the increase in the limit on length-of-service increments, and the increase in the maximum pensions including COLAs provided for under the bill will, in the aggregate, result in the following statewide actuarial costs to the 621 pension systems operating under the benefit provisions of Act 600.

|  | <b>Amount Range</b>              |                          |
|--|----------------------------------|--------------------------|
| Increase in Unfunded Actuarial Accrued Liabilities | \$59,000,000 – \$65,000,000      |                          |
|  | <b>Amount Range</b>              | <b>As a % of Payroll</b> |
| Increases in Employers’ Annual Costs               |                                  |                          |
| Normal Costs                                       | \$2,700,000 – \$3,100,000        | 0.69% – 0.80%            |
| Amortization Payments <sup>1</sup>                 | <u>\$6,257,000 – \$6,893,000</u> | <u>1.61% – 1.77%</u>     |
| Total Increase in Employers’ Annual Costs          | \$8,957,000 – \$9,993,000        | 2.30% – 2.57%            |

<sup>1</sup> Amortization payments are the same amounts each year for 15 years.

**POLICY CONSIDERATIONS**

In reviewing the bill, the Commission staff identified the following policy considerations:

Absence of Cost Sharing. Municipal Police Pension Law plans historically have been contributory, with the members contributing toward their retirement benefits. The material costs resulting from the proposals in the bill would be imposed entirely upon the affected municipalities without any increased contributions by the benefitted members.

**POLICY CONSIDERATIONS (CONT'D)**

Increased Benefit Disparity. Increasing the survivor's benefit to 60 percent of the deceased officer's pension will increase the disparity between the actuarial present values of the pensions of two otherwise identical retiring police officers, one of whom has a spouse or minor children and the other of whom who has neither.

Increasing Basic Pension Benefit. For most affected police officers, reducing the minimum period over which to compute the final average salary to the last two years of employment will increase their basic pension benefit amounts.

Appropriate Remedial Action. Periodic modification of the flat dollar limits on length-of-service increments is appropriate because of the erosion of the value of the limits that has resulted since they were established initially. To ensure that the provisions for length-of-service increments in the Law serve the intended purpose, the language should provide that the increment for each year of service beyond 25 years be no more than \$100 per month and that the length-of-service increments total no more than \$600 per month.

Potential for Manipulation. The proposed reduction in the period used to determine the final average salary would make manipulation` of the retirement benefit through overtime compensation or promotions easier.

Commonwealth Mandate to Municipalities. The bill mandates retirement benefit changes for all affected municipal police officers' retirement systems. The appropriateness of the Commonwealth mandating municipalities to provide specific pension benefits is questionable from a public policy standpoint due to the wide variation in local conditions.

**ATTACHMENTS**

House Bill Number 812, Printer's Number 947.

Actuarial Note prepared by David H. Killick of Conrad M. Siegel, Inc.