

TOWNSHIP OF LOWER MERION
Finance Committee
Issue Briefing

Topic: Pension Plans 1/1/2017 Actuarial Valuations; Adopt Smoothing Method to Determine Actuarial Value of Assets

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I. Action To Be Considered By The Board:

Consider for recommendation to the Board of Commissioners a resolution adopting a five (5) year smoothing method to determine the actuarial value of assets for the January 1, 2017 actuarial valuations of the Township's pension plans.

II. Why This Issue Requires Board Consideration:

In accordance with the Municipal Pension Plan Funding Standard and Recovery Act of 1984 (State Act 205), the Board of Commissioners must take formal action for the Township to adopt smoothing as part of the January 1, 2017 actuarial valuations.

III. Current Policy Or Practice (If Applicable):

The Township has two defined benefit retirement plans. The Police Pension Plan covers all uniformed police officers and the Employee Retirement Plan covers all other Non-Uniformed Township staff. Township staff have been working with the Township Actuary to finalize the January 1, 2017 actuarial valuations for both the Police Pension Plan and the Employee Retirement Plan. These reports must be filed with the State by March 30th.

The Township's pension plans remain fully funded according to the draft results of the actuarial valuations. However, primarily due to the underperformance of the plans' investments in 2015 (0%) and 2016 (7%) versus the plans' assumed investment rate of return (7.2%) the plans' funded ratio has fallen from approximately 110% as of the 1/1/2015 actuarial valuations to 101% in the draft 1/1/2017 actuarial valuations. One other factor that has a smaller impact on the decline in the funded ratio is an update to the mortality tables used in the actuarial valuations. The current mortality tables are outdated (from 2000) and it was recommended by the Township Actuary, Township Auditor, and Pension Board to move to an updated mortality table. In the Police Plan, the financial impact of the new mortality tables is less than half of the value of the investment loss. In the Non-Uniform Plan, the financial impact resulting from the change in the mortality table is still secondary compared to the investment loss, but the mortality change is higher on a proportional basis than in the Police Plan due to demographic factors.

While the funded ratio is still over 100% the decline does place additional funding requirements (beginning in 2019) on both plans which will impact both employee contribution levels to the pension plans and the Township's contribution to the pension plans.

As the Township staff, Township Actuary (Conrad Siegel) and the Pension Board have conferred over the actuarial valuations for the plans' the option of implementing smoothing of assets to lessen the financial impact of the 1/1/2017 actuarial valuations was discussed. Smoothing recognizes the gains or losses the pension plans experience over a longer period of time (five years in this case), rather than immediately under the market value of assets which is the Township's current standard.

The Township has used smoothing in the past for similar reasons as recently as the 1/1/2009 and 1/1/2011 actuarial valuations. Since the 1/1/2013 actuarial valuations the Township has used the market value of assets. At the most recent Pension Board meeting, the Pension Board unanimously approved a recommendation to the Board of Commissioners to adopt smoothing as part of the 1/1/2017 actuarial valuation for both pension plans.

IV. Other Relevant Background Information:

Traditionally, the Township has been able to fund its annual pension costs, known as the Minimum Municipal Obligation (MMO) with pension state aid received annually from the Commonwealth and employee contributions. The fact that no General Fund Township contribution is typically made to the pension plans is a sign of the Township's pension plans' strength and prudent management over many years and stands in stark contrast to most comparable governments.

The MMO is completed by the Township's CFO, reviewed by the Township Actuary and then by the end of each September the Chief Administrative Officer of the Pension Plans (the Township Manager) must certify to the governing body what will be the following year's MMO for its pension funds. The MMO can be revised prior to December 31st as the Township has done on occasion. Thus the 2019 MMO will be transmitted to the Board of Commissioners by September 30, 2018.

While the MMO is completed annually, actuarial valuations of pension plans are completed biannually for each odd numbered year. Each actuarial valuation is a snapshot in time of the funded status of a pension plan. The results of the actuarial valuation are then used to help compute the annual MMO. An actuarial valuation must be used for a minimum of one year and a maximum of three years depending on the speed at which the actuarial valuations are completed and the policy preference of the municipality. The Township is using the 1/1/2015 actuarial valuation for its 2018 MMOs which is the final year it may do so. The Township must use the results of the 1/1/2017 actuarial valuation for 2019 which is the cause of the increased funding needs.

The Township did enjoy strong investment returns during 2017 of approximately 16.7% which is far in excess of the 7.2% assumed investment rate of return. These positive results will be reflected in the 1/1/2019 actuarial valuation. While 2018 investment returns are not yet known, there is the potential that with modest to strong returns in 2018, the Township's 1/1/2019 actuarial valuations will be improved. This may decrease the level of Township contributions from the General Fund and reduce employees' pension contribution levels by as early as 2020.

V. Impact On Township Finances:

As noted earlier, despite the Township's funded status of over 100% in both its pension plans the result of the 1/1/2017 actuarial valuations requires additional funding. This additional funding will be needed in 2019 (no impact in 2018). In the Non-Uniform plan any additional funding requirement will continue to be funded solely via pension state aid and employee contributions. Employee contributions are currently 5% for employees hired after 2003 and are on a sliding scale (4% or less) for longer tenured employees. Employee contributions may need to increase in 2019 within the guidelines of the current WA contract, but no additional Township funding for the Non-Uniform plan is anticipated at this time.

The Police Plan will require additional funding in 2019 as well. It is projected that uniformed police employee contributions will need to rise from the current 1.2% to 5.0% which is the maximum according to PA Act 600. In addition, if smoothing is adopted the Township will need to contribute an estimated \$615,000 from its General Fund to the Police Pension Plan in 2019. Without smoothing the Township's contribution is projected to be \$820,000. The \$615,000 contribution from the General Fund, equates to less than 1% of the 2018 Adopted General Fund Budget which is far less than most local governments in this region and nationwide pay annually.

If smoothing were implemented the Township would have a funded ratio of 103% in the 1/1/17 valuations versus the 101% estimated if market value of assets were the standard.

VI. Staff Recommendation:

Staff recommends the resolution be approved at the March 21, 2018, Board of Commissioners meeting.