



Police Pension Calculation and Benefit History

MFRAC Meeting
October 26, 2021

Presentation Overview



- Yesterday, the Receiver issued an order to the City of Chester’s Pension Board to change the way that it has calculated pensions for police retirees hired before February 1, 2017, and to investigate and adjust the pension benefits for police retirees hired after January 1, 1988 and prior to February 1, 2017, who retired on a normal retirement.
- Based on the Receiver team’s analysis, certain police retirees have been receiving a pension benefit greater than what they were entitled to under their collective bargaining agreements. This appears to have been happening for years.
- Specifically, certain police retirees’ pensions were incorrectly calculated using the final pay over the retirees’ last 12 months of employment rather than the average of the last 3 years. The incorrect calculation allows police officers to artificially “spike” pensions
 - This does not apply to police officers hired after February 1, 2017 or those hired prior to January 1, 1988 who retired on a normal retirement
- The presentation explains why the Receiver issued this order and provides the rationale supporting that decision

Presentation Overview *(continued)*



- This presentation also provides some insight into how Chester’s police pension fund got into the trouble it finds itself in today. While we have historically focused on the fact that the City underfunded the police pension fund – which is true – we have not spoken about the pension benefit enhancements over the years which contributed to the significant benefit costs faced today. This presentation begins to discuss the police pension benefit enhancements that contributed to these significant benefit costs.
- What was most frustrating in conducting this review is that Chester appeared to be on the course to contain pension costs however pension benefit increases – some of which were agreed to – undid prior reforms.



Pension Funding Background



City's True Pension Situation

- Although many Pennsylvania cities have underfunded pensions, as of 1/1/2019, Chester's situation is the worst among Pennsylvania cities. The following table reflects the funding percentages of the plans in the 1/1/19 valuation.

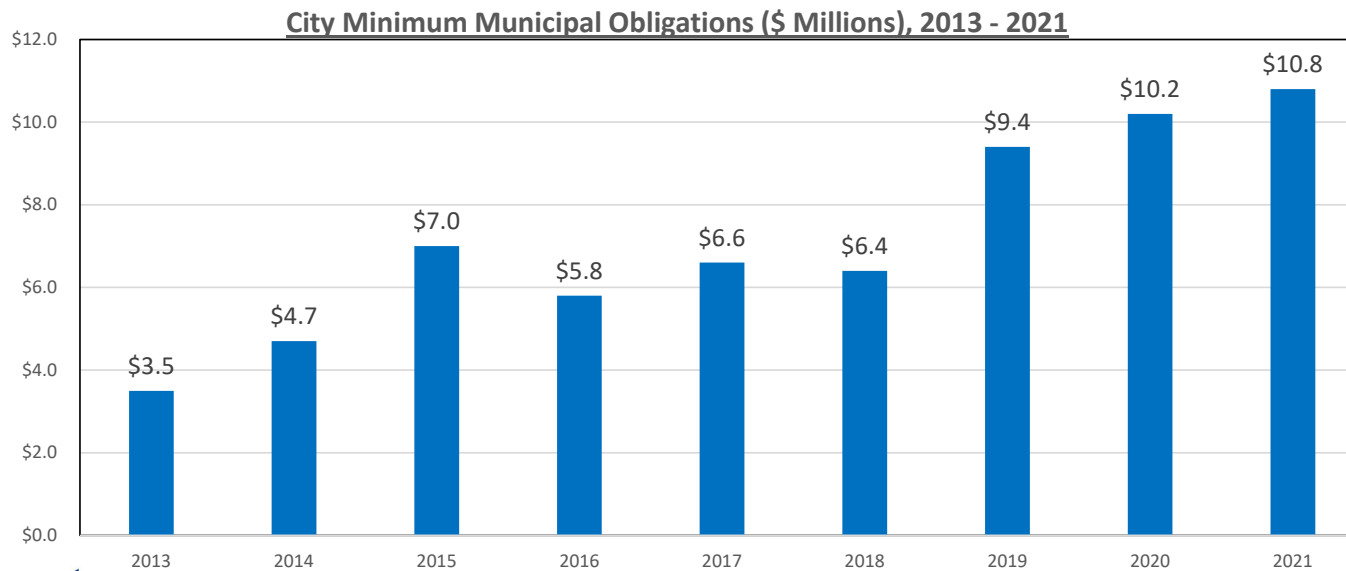
	Police	Fire	O&E	Total
Liabilities	\$83,195,607	\$39,891,425	\$8,028,817	\$131,115,849
Assets	\$27,992,535	\$33,275,475	\$2,674,647	\$63,942,657
Unfunded Liability	-\$55,203,072	-\$6,615,950	-\$5,354,170	-\$67,173,192
Funded %	33.6%	83.4%	33.3%	49%

- However, the problem is even worse than what appears in the 1/1/2019 valuations because those calculations treat the MMO contributions that the City did not make in prior years and still owes as if that money was already in the plan because they are "receivables" due to the plan.**
- In the above table, the police pension plan appears to have \$27,992,535 in assets as of 1/1/2019 with a funding percentage of 33.6%. However, almost all of those assets are "receivables." Excluding the receivables, as of 12/31/2019, the police pension plan's funding percentage was closer to 3%. **As of the end of September 2021, the police pension plan has approximately \$2.7 million or the equivalent of about five months of payments**
- Excluding receivables, which is a more accurate reflection of reality, the annual City pension payment for 2021 would be **\$2 million more than originally provided - \$12.8 million rather than \$10.8 million.** The City simply cannot afford this.

City Pension Cost Growth



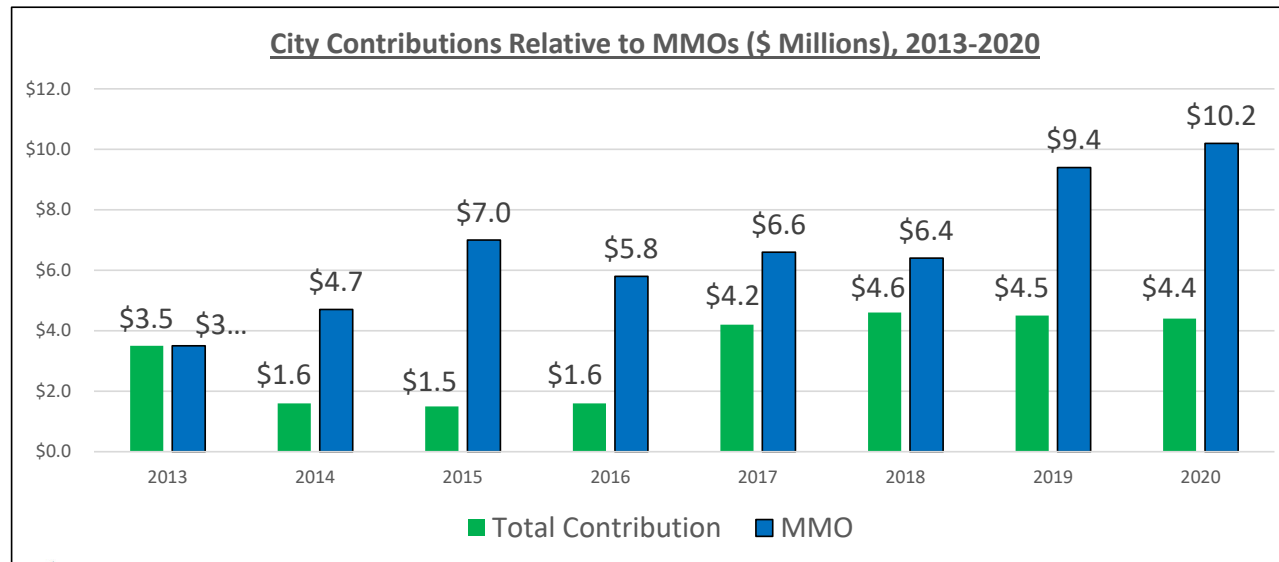
The City's combined annual contributions to its pension funds (called Minimum Municipal Obligations or MMOs) for its three pension funds has more than tripled since 2013.



How Did Things Get So Bad in the Pension Funds?



- The City fell behind on its MMO payments in 2014 and has never been able to catch up (not the “true” MMO)





Pension Calculation Basics

How a Pension Is Typically Calculated



- Generally speaking, the formula for determining the amount of a retiree's normal retirement pension (i.e., non-disability) and when they can receive it has several components:
 - Age requirement: How old the employee is
 - Years of service requirement: How many years the employee worked
 - Multiplier: Percentage amount that is either multiplied by the employee's years of service or a flat percentage amount once an employee works a certain number of years
 - Final Average Salary: The employee's salary component that can be averaged over a period of time and that can contain various cash compensation elements including overtime
- The pension formula is usually:
 - Years of Service x Multiplier x Final Average Salary = Pension Amount

How a Pension is Typically Calculated

Example



- Assume that a pension plan allowed an employee to retire after the employee reached age 50 (age requirement) and 20 years of service (service requirement) with a 50% (multiplier) of final average salary of the last 3 years of employment. Also assume that the employee earned \$100,000; \$120,000; and \$125,000 in their last 3 years which averages out to \$115,000
- The pension calculation for this employee would be:
 - 50% (multiplier) x \$115,000 (final average salary) = \$57,500 per year

Chester Police Pensions

Officers Hired After 1/1/1988 and Prior to 2/1/2017



- For Chester police officers hired after January 1, 1988 and prior to February 1, 2017, their pensions have been calculated as follows:
 - Age requirement: None (eliminated in 2003-2005 Butler MOU)
 - Years of service requirement: 20 years of service
 - Multiplier: 50% of final average salary
 - Final Average Salary: Last 12 months of W-2 wages
- At issue here is that based on a review by the Receiver's team, the Final Average Salary should not be the last 12 months but rather the average salary of the last 3 years preceding retirement



Police Pension Calculation Order

Receiver's Order *Background*



- Over the last several months, the Receiver's team has been working to better understand the City's police pension situation including how things got to where they are today
- As part of that analysis, the Receiver's team traced the changes from 1972 onward in collective bargaining agreements, memoranda of agreements and interest arbitration awards
- Based on that analysis, and conversations with others, the Receiver's team concluded that police officers hired after January 1, 1988 and prior to February 1, 2017, and retiring on a normal pension should have their pension calculated using the officers' average salary in the 3 years preceding retirement rather than the last 12 months which has been occurring (final average salary)
 - Using the last 12 months allows "pension spiking" which results in police officers receiving a significantly higher pension by working many overtime hours in the last year of employment

Impact of Which Calculation to Use

Example



- To help explain the impact of using the last 12 months of pay versus the average of the last 3 years, we provide the following example:
 - Assume a police officer retiring on December 31, 2020, earned the following in his or her last three years of employment:
 - 2020 (last 12 months): \$200,000
 - 2019: \$120,000
 - 2018: \$110,000
 - Under the pension calculation, his or her pension would be 50% of what is defined as the final average salary
 - The next slide shows the difference in the pension if one defines final average salary as the last 12 months compared to the average of the last 3 years

Impact of Which Calculation to Use

Example (continued)



Pension Calculation Using Last 12 Months

- Final average salary would be \$200,000
- 50% of final average salary would be \$100,000
- Therefore, the retiree's annual pension would be \$100,000

Pension Calculation Using Average of Last 3 Years

- Final average salary would be the average of \$200,000; \$120,000; and \$110,000 which is \$143,333
- 50% of final average salary would be \$71,667
- Therefore, the retiree's annual pension would be \$71,667 **which is \$28,333 or 28.3% less than using the last 12 month final average salary**

Who Does This Change Impact Most?



- Mathematically speaking, moving from calculating the final average salary from the last 12 months to the last 3 years should not have a significant impact on a police retiree’s pension unless the retiree earned a significant amount more in the last 12 months as compared to the two prior years before that – i.e., unless the retiree “spiked” his or her pension
- Pension spiking occurs when employees artificially inflate their compensation in the time immediately preceding retirement (usually by working large amounts of overtime) in order to receive larger pension than they otherwise would be entitled to receive
 - In Chester, we have heard the term to describe this as “making their run”

Who Does This Change Impact Most?

Example (Non-Spiking)



Pension Calculation Using Average of Last 12 months

- Assume employee earned \$100,000; \$103,000 and \$106,000 in their last 3 years
- 50% of final average salary of \$106,000 would be \$53,000
- Therefore, the retiree's annual pension would be \$53,000

Pension Calculation Using Average of Last 3 Years

- Final average salary would be the average of \$100,000; \$103,000; and \$106,000 which is \$103,000
- 50% of final average salary would be \$51,500
- Therefore, the retiree's annual pension would be \$51,000 which is \$1,500 or 2.8% less than using the last 12 month final average salary

Who Does This Change Impact Most?

Example (Spiking)



Pension Calculation Using Last 12 Months

- Assume employee earned \$110,000; \$120,000 and \$200,000 in last 3 years of employment. Final average salary would be \$200,000
- 50% of final average salary would be \$100,000
- Therefore, the retiree's annual pension would be \$100,000

Pension Calculation Using Average of Last 3 Years

- Final average salary would be the average of \$200,000; \$120,000; and \$110,000 which is \$143,333
- 50% of final average salary would be \$71,667
- Therefore, the retiree's annual pension would be \$71,667 **which is \$28,333 or 28.3% less than using the last 12 month final average salary**



Act 205 Studies

- The Pennsylvania Municipal Pension Funding Standard and Recovery Act, commonly known as “Act 205,” applies to the police pension plan and sets forth specific requirements prior to changing any pension benefits
- Specifically, prior to any pension change, Act 205 requires a cost estimate of the effect of a pension benefit change to be provided to the municipality’s governing body
- We found no such cost estimate prior to the change of the benefit formula to use the last 12 months instead of the 3-Year formula



Police Pension Benefit History

Police Pension Benefit History



- In conducting our analysis, we reviewed collective bargaining agreements, memoranda of understanding (MOUs) and interest arbitration awards dating back to 1972 to trace the changes in the police pension benefit and retiree health care
- The history showed an increasing pension benefit level until the period around 1987-1989 where reforms were agreed to in a MOU that created new benefit tier for police officers hired after 1987
- Many of those reforms were eliminated in the 2003-2005 MOU and the pension benefit was also enhanced in a 2012 interest arbitration award



Pension and Retiree Benefit History

Key

- Benefit Established
- Enhancement
- Reduction

Source	Applicability	Action
1972 Arbitration Award	Pension	Established retirement eligibility at Age 50 with 20 YOS
	Pension	Increased Service Connected Disability retirement from 50% to 70% of final average salary
1977 Arbitration Award	Pension	Eliminated Social Security offsets for disability retirements
	Pension	Established guaranteed minimum of 25% of salary for Non-Service Connected Disability retirements with 5 YOS, up from previous 2.5% per year of service
1978-1979 Arbitration Award	Pension	Established new killed in service survivor benefit
1980 Agreement	Retiree Medical	Allowed post-1/1/1980 retirees to participate in City healthcare plans, but required employees to pay 100% of premiums
1981 Reopener on Disability	Pension	Increased Service Connected Disability after 1/1/1982 to 100% of W-2 earnings in last 12 months

Pension and Retiree Benefit History



Key

- Benefit Established
- Enhancement
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Source	Applicability	Action
1983 -1984 Agreement	Pension	Established vesting at 20 YOS (must also be age 50 to collect pension)
	Pension	Increased final average salary to 50% of W-2 earnings in 12-month period prior to retirement
	Pension	Added Workers' Compensation payments to definition of final average salary for Service Connected Disability retirements
1987-1988 Agreement	Pension	Added provision to convert Service Connected Disability retirements to a regular pension benefit (50%) at their normal retirement eligibility (from 1987 arb award)
	Pension	Reflects 12-month final average salary formula for all Officers
	Retiree Medical	City pays 100% of premiums for BC/BS + Rx (\$2) for employees retired after 1/1/1987 at 2-party coverage level, up from 100% employee paid

Pension and Retiree Benefit History



- Importantly, the City and Union took steps in the 1989 agreement to begin curtailing the unsustainable benefit levels by creating a new pension benefit tier for police officers hired after 1987. Unfortunately, as we will see, most of these changes were reversed in the 2003-2005 agreement and were further enhanced by an arbitration award covering 2012 through 2016

Source	Applicability	Action
1989 MOU	Pension	Added military service credit option
	Pension	Increased normal retirement to Age 53 with 25 YOS for post-5/19/1988 hires
	Pension	Benefit level established at 50% of highest average pay for 3 calendar years for post-5/19/1988 hires
	Pension	Reduced Non-Service Connected Disability formula to 2% average pay per YOS up to 50% maximum for post-5/19/1988 hires

Key

Benefit Established
Enhancement
Reduction



Pension and Retiree Benefit History

- The last signed, consolidated collective bargaining agreement between the City and the police union covered 1998 through 2002*. That document memorialized two significant items – 1) removing the conversion of service-connected disability retirement to regular retirement and 2) memorializing the pension tier for police officers hired on/after January 1, 1988

Source	Applicability	Action
1994-1997 CBA and 1998-2002 Agreement (last signed, consolidated agreement)	Pension	Removed conversion of Service Connected Disability retirement to regular retirement for post-5/19/1988 hires (meaning that it stayed at 100% rather than dropping to 50% once the disabled officer reached retirement age)
	Pension	Defines the “second tier” pension formula for police officers hired on/after January 1, 1988, as 50% of average annual salary received during the last 3 years of service immediately preceding retirement

* Note: This language also appeared in the 1994-1997 collective bargaining agreement which was passed by City resolution, but only signed by the City. The 1998-2002 CBA was signed by the FOP and the City.

Key

- Benefit Established
- Enhancement
- Reduction



Pension and Retiree Benefit History

- Much of the work to reduce pension costs was undone in the 2003-2005 agreement and the 2012-2016 interest arbitration award. The 2003-2005 agreement changed the retiree eligibility by removing the age eligibility and reduced the years of service requirement to 20 years. Importantly, however, it did not change the final average salary calculation.
- The interest arbitration award covering 2012 through 2016 also increased the pension service increment, but again did not change the final average salary calculation

Source	Applicability	Action
2003-2005 MOU	Pension	Changed retirement eligibility to Any Age with 20 YOS for post-1/1/2004 retirees (no mention of any changes to final average salary calculation)
2012-2016 Arbitration Award	Pension	Service increment increased from \$100 to \$500 per month for service in excess of 20 years
	Retiree Medical	Added dental and vision coverage to retiree medical benefits
2017-2021 MOU	Pension	Creation of new pension tier (see next slide) for police officers hired on/after February 1, 2017

Key
 Benefit Established
 Enhancement
 Reduction

Current Benefits – Police Pension Plan



- Positive steps have been taken to contain benefit costs, but legacy plan design continues to hamper financial sustainability
- Chester currently has a two-tier system for Officers hired pre- and post-February 1, 2017

Key Benefit Provisions	Pre-2/1/2017 Hires	Post-2/1/2017 Hires Third Class City Code
Service Retirement Benefit Formula	50% of FAS	50% of FAS
Final Average Salary (FAS)*	Officers have received highest 12 months, but should be average of last 3 years preceding retirement	Greater of 12 months or 5 year average
Compensation included in FAS	All W-2 earnings, including overtime	Base pay + longevity only
Age & Years of Service (YOS) Requirement	Any age with 20 YOS	Age 50 and 25 YOS
Service Credit	Up to 5 YOS for Military Service	Up to 5 YOS for Military Service
Service Disability Retirement	50% of FAS/70% of FAS for in the line of duty disability	50% of FAS/70% of FAS for in the line of duty disability
Deferred Retirement Option Program	Yes @ Age 50 with 20 YOS	Yes @ Age 50 and 25 YOS
Employee Contribution	8.0%	8.0%

Disability Pension Issue



- While not included in yesterday's order, the Receiver's team also noted that language which was awarded in the 1987 interest arbitration award that converted the 100% service connected disability benefit to a regular retirement benefit (50%) when the officer would be eligible for a full regular retirement was not included in the 1994-1997 and the 1998-2002 collective bargaining agreements.
- The Receiver's team is investigating why this occurred and may issue another order in the future

Conclusion



- Yesterday, the Receiver issued an order to the City of Chester’s Pension Board to change the way that it has calculated pensions for police retirees hired before February 1, 2017, and to investigate and adjust the pension benefits for police retirees hired after January 1, 1988 and prior to February 1, 2017, who retired on a normal retirement.
- Based on the Receiver team’s analysis, certain police retirees have been receiving a pension benefit greater than what they were entitled to under their collective bargaining agreements. This appears to have been happening for years.
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