

EVALUATING YOUR PENSION PLAN

- **How can we be sure you are the best?**
- **What are your strengths and weaknesses?**
- **How do we know you're doing a good job?**

As a state agency responsible for administering more than twenty percent of Pennsylvania's public pension plans, PMRS is often asked questions such as the ones above. To aid local government officials in evaluating their pension program, we have prepared answers to these and other pertinent questions. We also provide a brief overview of services that pension administrators can and should provide.

What is a pension administrator?

A pension administrator is an agency or an individual responsible for handling all activities associated with your pension plan. The administrator must be willing to assume some fiduciary responsibility for the operation of the plan.

What are typical pension activities?

Four key functions are associated with a pension plan: (1) Accounting/Record Keeping, (2) Investment/Money Management, (3) Actuarial Reporting, and (4) Employer-Employee Relations. It is essential that each function is performed well to have an efficient and successful pension plan that pleases the employees and the employer.

Does a single pension administrator need to perform all four key functions or can they be divided between individuals and agencies?

Each function can be delegated with good results provided responsibility is clearly assigned, coordinated, and overseen by a municipal official. Caution: One of the most common problems associated with a multiple approach is that the local government does not assign responsibility.

A money manager, unless specifically contracted, should not be expected to perform your actuarial work. Nor should your actuary be automatically expected to handle your bookkeeping, your money management, or even your employee counseling. Administrators can perform multiple functions, but be certain of which

functions they will perform and what functions will be left with the local officials. (Put it in writing.)

What is meant by fiduciary responsibility?

State and federal law explicitly state an individual's responsibility when acting on behalf of another. Under Pennsylvania's Act 205 of 1984, local government officials with pension plans have legal duties to report to state officials and governing boards. Failure to comply can result in certain legal penalties. There is also a clear level of expectation under the law when handling an employee's money in a plan. The "prudent person" fiduciary rule is a common level of expectation which cannot and should not be ignored.

Will the pension administrator assume the fiduciary responsibility for me?

No. The law specifically places fiduciary responsibility on the local officials' shoulders. A good pension administrator must be knowledgeable in these responsibilities and should be someone you can trust and depend upon to assist you in meeting your responsibilities. State law does not allow you to transfer the total fiduciary responsibility to your administrator. It is for this reason that the activities of the administrator should be reviewed and monitored.

Can you give additional details about the four key pension functions so that I have a clearer understanding of what to expect?

What follows is a brief discussion of the four key pension functions and some typical problems that could arise. There are also questions, divided by functions, which you should ask the pension administrator.

Accounting/Record Keeping

A good pension administrator will provide you with at least an annual accounting of all monies associated with your account. The statements should be concise, timely and understandable. They should track all money (employee, employer and retiree) associated with your account.

If you are investing in a mutual fund, are you informed of the value of the assets at cost and at market? If employee contributions are required, does each employee receive an annual statement showing the activities in the employee's individual account?

Does the employee understand the statement? And, probably most importantly, do your auditors or the Auditor General's (AG) auditors have difficulty auditing your accounts? Are the financial statements consistent with the current governmental accounting standards? Be certain you can ask the pension administrator questions about the statements because the auditors and the AG will possibly have questions for you or your administrator.

Investment/Money Management

Investment/money management is probably the most visible part of pension administration. Everyone wants to handle the money. How do you know whom to trust? General Grosvenor probably summarized the situation best when he said, "Figures won't lie, but liars will figure." Therefore, first and foremost, when talking about money management with money managers, identify risk and then talk actual experience.

Money management should be examined on a long-term basis because pensions usually do not become payable for twenty or thirty years after initial employment. As a result, you should ask to see a five- or ten-year listing of actual performance. Almost every money manager has a model which reflects a typical account. Do not accept this model as an indication of performance. Instead, ask for a specific account with details on initial contributions, continuing contributions, money withdrawn and present value.

Be certain that numbers from the specific account are net of fees. Also, it is important to be aware that fees are not always visible. Many insurance companies supposedly charge "no fees" to manage the money that is on deposit until the time you want to withdraw it. It is common to have a five percent surrender clause. Stated another way, the money manager knows from the beginning that the company will have five percent of the assets if you terminate your contract.

Again, we highlight risk. Know the type of securities in which you are investing. A guarantee is not necessarily a guarantee. How secure is the money management firm? Does the firm invest in quality stocks and bonds and diversify risk through appropriate asset allocations?

Actuarial Reporting

State law (Act 205 of 1984) requires at least a biannual actuarial valuation of most pension plans which must be performed by a qualified actuary. Does your pension administrator perform the actuarial

valuation? At what cost? Is the administrator familiar with the certification requirements? Does the administrator have actuaries that meet these requirements? Does the administrator complete the entire Act 205 Report or just the actuarial section?

Your plan must also be funded in accordance with the actuarial report. Does the plan administrator prepare the Minimum Municipal Obligation? If so, what is the annual charge?

When working with actuarial information, one often faces a professional language barrier. It is important that the pension administrator not only understands the actuarial requirements, but also is willing to meet with you to explain requirements in everyday, understandable terms.

Employer-Employee Relations

Probably the most taken-for-granted aspect of pension administration is the employer-employee relationship. Your employees should have a good understanding of their pension plan. It is imprudent to provide a benefit that employees do not understand, particularly one that needs to provide financial security in the future. Therefore, a plan description that explains the plan benefits is extremely helpful. It is also advisable for the plan administrator to understand the benefits and explain them clearly to the employees. A benefits meeting with the employees once every two or three years is strongly encouraged.

As an employer, you should understand and be comfortable with the benefits for which you are paying. Nothing is worse than funding a plan for twenty years and then finding out shortly before an employee retires that the benefit is not what the employer or the employee expected. A good pension administrator should be able to work with you in designing a plan that meets your needs, finances and expectations.

General Questions to a Pension Administrator:

As an easy reference for items and issues to examine when considering a pension administrator, the Pennsylvania Municipal Retirement System's staff suggests you ask the following:

- Do you handle all aspects of the pension: accounting/record keeping, investment/money management, actuarial reporting, and employer-employee relations? If not, which ones do you handle? Be specific.

- How long has your agency been in business? How long has the representative handling the account been associated with your agency?

- How many Pennsylvania municipal plans does the pension administrator currently handle? Obtain names and phone numbers of three municipal plans within the area that have had the pension administrator for at least five years. Then, call the references.

Accounting/Record Keeping Questions:

- How often are employer financial statements provided?

- Who distributes the retirees' checks? Is there a charge? Who will mail the tax reporting forms?

- Are the financial statements provided in accordance with current Governmental Accounting Standards Board (GASB) standards?

- Is the pension administrator willing to work with the auditors to explain the accounting, if necessary?

Investment/Money Management Questions:

- What securities are being bought and sold? What guarantee of security is provided? What is the management fee?

- Is there a withdrawal penalty? A transaction cost? If so, how much?

- Will you provide a specific client's statement for the last five- or ten-year period? (Calculate the return net of fees.)

- Upon withdrawal, how soon is the money paid out? What are the withdrawal provisions?

- If the fund is with an insurance company, what is the "Best Insurance Reports-Life/Health" rating? What is the company's percentage of reserves to liabilities?

Actuarial Reporting Questions:

- Does the pension administrator utilize an actuary that meets the certification requirements of Act 205 of 1984?

- Is the complete Act 205 report prepared by the administrator? If not, what portions are? Will the plan administrator meet with the governing board to explain the report? Is there a charge for preparing the report? Is there a charge for meeting with the board?

- What is the estimated cost to complete the actuarial report? Does this include (1) the possible plan changes, (2) actual calculation of retirement benefits, and (3) the calculation of the Minimum Municipal Obligation?

- How much of your staff's time will be spent providing information to the actuary?

Employer-Employee Relations Questions:

- Does the plan administrator provide specific summaries to the employees? Do the employees get individual statements? Retirement estimates?

- Will the plan administrator meet with the employer to explain the benefits? With the employees? Is there a charge?

- Can the pension plan be altered in the future? Will the plan administrator assist in the plan design?

- Does the administrator assist the retirees in federal tax questions and withholding?

Final Suggestion:

- Ask the pension administrator to name the three most positive aspects of the plan administration *and* the three biggest weaknesses.

When evaluating your pension administrator or a potential administrator, the above questions should not be considered the complete list by which you should evaluate the pension administrator. Rather, the questions should be viewed as the foundation on which you can begin your evaluation.

This brochure was prepared by the staff of the Pennsylvania Municipal Retirement System (PMRS), a state agency created by Act 15 of 1974. If staff can be of further assistance, please call our toll-free number, 1-800-622-7968, or e-mail us at: ra-staff@state.pa.us.

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