August 17, 2012

TO THE MEMBERS OF THE HOUSE OF REPRESENTATIVES
OF THE 146TH GENERAL ASSEMBLY:

Pursuant to Article III, Section 18 of the Delaware Constitution, I am vetoing House Bill No. 387 by returning it with my objections to the Delaware House of Representatives without my signature.

House Bill No. 387 would provide retirees in closed pension plans for the City of Wilmington Police and Fire Departments with biennial direct payments from the State. The payments, which will average more than $5,000 at first, and could grow substantially beyond that, are not pension increases. Instead, they are direct payments from a fund created with state tax dollars that was originally intended to fund pension increases. Current law already allows these funds to be used to finance municipal and county police and fire pension increases if the local government is willing to pay 25% of the costs. House Bill No. 387 circumvents the City of Wilmington’s role under this law and directs a portion of these funds directly to City of Wilmington police and fire pensioners. By doing so, the bill effectively eliminates the 25% cost-share for the City and creates a payment structure outside of the regular pension system. This bill would eventually result in direct payments of tens or hundreds of thousands of dollars each to a few Wilmington police and fire pensioners.

For the following reasons, I do not think transferring state tax dollars directly to municipal pensioners in the manner proposed in House Bill No. 387 is a sensible policy for retirement benefits and I am vetoing the bill.

Let me begin by describing the current structure for state tax-financed pension increases for local police and fire department retirees. Since 1990, Delaware insurance customers have paid a supplemental 0.25% tax on premiums for most insurance. 18 Del. C. § 708(a); 67 Del. Laws c.327. Each year, this tax generates approximately $8 million that is set aside in a special fund to benefit county and municipal police pension funds. Of that amount, approximately $5 million is paid directly to the operators of county and municipal police pension funds, which assists New Castle County and several municipalities with ongoing pension commitments. 18 Del. C. § 708(b).
Another approximately $3 million is deposited annually into a special fund, managed by the Board of Pension Trustees, to provide post-retirement increases, over and above the pension benefits originally promised, for certain retired county and municipal police and firefighters. *Id.* at § 708(c). This fund is known as the County & Municipal Police and Firefighters' COLA Fund (the "COLA Fund"), and is the subject of House Bill No. 387.

Only three county or municipal governments benefit from the COLA Fund. The City of Wilmington, New Castle County, and the City of Dover all meet the requirements of Section 708(c) because they operate their own local police and firefighter pension funds and elected to participate in the State-administered County and Municipal Police/Firefighter Pension Plan for employees hired after they joined the State-administered plan.\(^1\) *Id.* That is, in each of these localities the more recently hired police or firefighters participate in the State-administered pension plan, but employees and retirees hired before the locality joined the state-administered plan still participate in a locally-administered pension plan that is "closed" to new members.\(^2\)

The COLA Fund exists to finance post-retirement pension increases in these closed pension plans. The funds are divided proportionately among these eligible pension plans based on the number of retirees, although the City of Wilmington's police and fire retirees represent about two-thirds of the total. To access the COLA Fund, each local government must propose a planned pension increase to the Board of Pension Trustees and commit local funds to cover 25% of the costs.\(^3\) *Id.* at §708(c)(2). If the locality does not request a pension increase and finance it with matching funds, then funds sitting unused for more than five years will revert to the state General Fund. *Id.* at §708(c)(3). Those unused amounts that revert have contributed to the general obligations of state government to finance teachers, state parks, highway construction and other programs.

New Castle County and the City of Dover have used their portion of funds to provide cost-of-living adjustments guaranteed in their pension plans. Each has paid at least the 25% match required by the law. The City of Wilmington has used the funds to provide periodic increases, the last of which was requested by the City and approved by the Board of Pension Trustees in 2006. Because the City's portion of the COLA Fund has not been used to grant an increase since 2006, Wilmington's unused portion of the COLA Fund has grown over the years and been used to support the state General Fund.

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\(^1\) The Town of New Castle and the Town of Elsmere both also qualify to benefit from the COLA Fund, but each has fewer than 10 retirees in its closed pension plan and neither has ever sought to grant a post-retirement pension increase from the COLA Fund.


\(^3\) The original law required a 50% matching contribution from the local government. That was lowered to 25% in 1996. 70 Del. Laws c.464 § 1 (July 9, 1996).
House Bill No. 387 circumvents the City of Wilmington's decision not to use the COLA Fund to grant an increase in pensions. It proposes that rather than requiring the City to finance 25% of any increase, the COLA Fund instead be used to finance a biennial disbursement directly to eligible retirees. The Board of Pension Trustees would determine the total amount to distribute, as long as $500,000 remains in the fund after the biennial distribution. Practically, this $500,000 requirement excludes Dover and New Castle County pensioners from benefitting from the bill in the near-term because neither government generally maintains balances in their portions of the COLA Fund in excess of that amount due to their smaller size and ongoing obligations to fund previously granted cost-of-living-adjustments.4

The Board of Pension Trustees is required to make disbursements under House Bill No. 387. The Board retains discretion over only the amount of the total disbursement. It met recently and decided that if House Bill No. 387 becomes law, it will allocate $3.8 million for disbursement this September to participants in the City’s closed police and fire pension plans. Although each retiree’s payment will depend on his or her years since retirement, the average retiree payment is likely to be more than $5,000. The bill requires that this process repeat itself in 2014 and every other year thereafter.

In short, the bill effectively provides biennial transfers to City of Wilmington police and fire pensioners that avoid any involvement by the City of Wilmington or any locally-funded matching contribution. While I appreciate the General Assembly’s desire to see that this money benefits the persons for whom it was intended, the direct payment scheme in House Bill No. 387 has three significant flaws.

First, House Bill No. 387’s elimination of the locally-funded matching contribution is unfair to those local governments that have made those payments up to now – New Castle County and the City of Dover. Each of those governments pays its 25% matching contribution for post-retirement pension increases from the COLA Fund. If this law passes, the City of Wilmington will basically become exempted from any similar requirement. If taxpayers in New Castle County and Dover have to bear one-quarter of these costs, the City of Wilmington should have a similar obligation.

Second, House Bill No. 387 eliminates local control over the amounts received by local police and fire pensioners. Until this bill, the local police and fire county and municipal pension plans were locally-administered by the local government that created them. The COLA Fund provided a source of supplemental funding, but the local government's matching obligation meant that the governments involved – the City of Wilmington, the City of Dover, and New Castle County – still controlled whether to increase payments to its police and fire pensioners. This bill fundamentally removes much of that local control by dictating that if an eligible local government fails to grant a pension increase, the General Assembly will require that the COLA Fund be used to provide a new

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4 This may change in the future as the Dover and New Castle County pension obligations in the closed plans decrease, but the stream of insurance premium tax revenues supporting those obligations continues.
stream of biennial payments directly to the pensioners. These are locally-administered pension plans and I do not think it is appropriate to remove local control of the amounts paid to a city or county government’s pensioners.

Third, to avoid any involvement from the City, the bill redirects a significant revenue stream -- approximately $2 million annually -- directly to a finite set of retirees in the City of Wilmington’s closed police and fire pension plans. While there are approximately 700 pensioners in those plans currently, the number of participants in the closed pension plans will diminish over time. In contrast, the insurance premium revenue will likely increase with each passing year. As a result, over the next ten or twenty years the biennial payments to each remaining pensioner will grow and grow, until only a limited number of surviving pensioners will be dividing approximately $4 million every two years.

This is not a sensible result. While the current year’s payments to pensioners are certainly well-intended, a law that creates the chance for a handful of survivors to collect tens or hundreds of thousands of dollars biennially is not appropriate public policy. It creates a situation in which the last remaining beneficiaries of the closed pension plan will be collecting more from this biennial payment than they do from their pensions. This is not a fair result for the other police and fire pensioners and other state and local employees who do not participate in such a fund. Nor is it easily justified to taxpayers.

I recognize that there are many pensioners of the City of Wilmington police who would like to see a pension increase of some kind and will be disappointed that House Bill No. 387 does not become law. But the City needs to pay only 25% of the actuarial costs of any post retirement increase to achieve a better result – a real pension increase seen in every pension check, not just a once-ever-other-year payment that balloons for pensioners who outlive their colleagues. I recognize that public funds are limited, but financing a 2% pension increase from the COLA Fund would likely require the City to contribute less than $100,000 a year over the amortization period. Whether to do that should be the City's decision, not the General Assembly's.

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5 For example, when the surviving retirees number approximately 100, the average biennial payment would be $40,000. When the surviving retirees number 10, the average biennial payment would be $400,000. Some have argued that this kind of windfall can be avoided if the Board of Pension Trustees just allocates less money to the pensioners. But there is nothing in the bill that suggests the Board should exercise discretion to decide how much payment would be excessive. Nor should that decision be made by appointed board members. The amount to be paid to pensioners should be decided by the elected officials of the local government that manages the pension plan.
For these reasons, I have concluded that it is necessary to veto House Bill No. 387 by returning it to the House of Representatives without my signature.

Sincerely,

[Signature]

Jack A. Markell
Governor