

REPORT OF
THE SPECIAL COMMISSION TO STUDY THE
MASSACHUSETTS CONTRIBUTORY RETIREMENT SYSTEM
SUBMITTING PROPOSALS TO THE CHIEF ACTUARY OF PERAC FOR COSTING

SUBMITTED
SEPTEMBER 1, 2009

Special Commission Members

Alicia Munnell, Director of the Center for Retirement Research at Boston College
Special Commission Chair by appointment of the Governor

Peter Diamond, Professor of Economics, MIT
Professional Expert, by appointment of the Governor

Kathy Riley
Actuary, Professional Expert, by appointment of the Governor

Nancy McGovern
AFSCME, Labor Representative, by appointment of the Governor

Senator Kenneth Donnelly, former PERAC Commissioner
Designee, President of the Senate

Representative Robert P. Spillane, Chair, Joint Committee on Public Service
Designee, Speaker of the House

Senator Thomas McGee, Chair, Joint Committee on Public Service
Designee, President of the Senate

Representative Michael J. Rodrigues, Vice Chair, Joint Committee on Public Service
Designee, Speaker of the House

Senator Michael R. Knapik
Designee, Senate Minority Leader

Representative Todd M. Smola
Designee, House Minority Leader

Joseph E. Connarton
Executive Director, Public Employee Retirement Administration Commission

Nicola Favorito
Executive Director, State Retirement Board, Deputy State Treasurer

Kate Fitzpatrick, Town Manager, Town of Needham
Member, Massachusetts Municipal Association

Pam Kocher, Deputy Chief of Staff, Executive Office for Administration and Finance
Designee, Secretary of Administration and Finance

John Parsons, General Counsel, State Auditor's Office
Designee, Auditor of the Commonwealth

Joan Schloss
Executive Director, Massachusetts' Teachers' Retirement System

Ralph White
President, Retired State, County and Municipal Employees Association of Massachusetts

I. Introduction

The Special Commission to Study the Massachusetts Contributory Retirement System has met nine times since March 2009, and its three subcommittees have held additional meetings. During that process, the Commission has discussed a large number of proposals for new employees, and many of these proposals are included in this document. The inclusion of a proposal in this report does *not* mean that the Commission supports it, but rather that it needs to understand how the proposal would affect costs and the well-being of future public employees.

II. The Challenge

The Commonwealth of Massachusetts' public employee retirement system provides similar retirement and disability benefit levels as other states with defined benefit plans and no Social Security coverage, and, before the recent financial collapse, the system was on a path toward full funding by 2028.

Yet, taxpayers often perceive the retirement system as excessively generous, particularly in the wake of celebrated abuses reported in the press. But the public often fails to recognize that public employees are not covered by Social Security and make substantial contributions to their own benefits. Moreover, taxpayers are often unaware that their taxes have been contributing mostly to pay off the system's large unfunded liability, and not to pay for the state's contribution towards the benefits being earned by current workers. In fiscal year 2008, 77 percent of the Commonwealth's \$1.3 billion contribution to State and Teachers' pensions went to cover the unfunded liability; only 23 percent went to pay for the normal cost, the cost of benefits earned by current employees in that year.¹

Public employees and their employers are also concerned about the system. Employees have seen increasing contribution rates for new employees, perceive that some can "game" the system at their expense, and worry that once retired their benefits will be heavily eroded by inflation due to limited cost-of-living adjustments. Employers are concerned about their ability to attract and retain good quality employees.

In June 2009, the Massachusetts Legislature passed unanimously and the Governor signed a bill addressing what were viewed as some of the most egregious abuses in the Massachusetts Contributory Retirement System. The enactment of these reforms enabled this Commission to concentrate on the fundamental structure of the system.

The Commission agreed from the outset that, as a matter of fiscal policy, Massachusetts should continue to oppose Social Security coverage of its public employees, because the costs would exceed the benefits. While Massachusetts employers and employees each would be required to pay 6.2 percent of payroll to Social Security, only three quarters of that amount would pay for benefits; at least one quarter would go to cover Social Security's legacy costs, associated with having provided benefits in excess of

¹ Commonwealth of Massachusetts Retirement Systems, *Actuarial Valuation Report, January 1, 2008*.

contributions to early generations. The Commission also agreed to retain the defined benefit structure, because it assures participants the most secure source of retirement income.

In the context of no-Social-Security and a defined-benefit structure, the Commission has discussed a number of changes that would improve the fairness and efficiency of the system for new employees and close some remaining loopholes. The Commission has also discussed whether some of the provisions for new employees might also be applicable to current employees.

What follows is an enumeration of some of the proposals considered by the Commission. They are included in this document not because the Commission supports each one, but rather to gain cost estimates for alternative strategies and/or to better understand their implications. Once cost estimates are provided by the Chief Actuary at the Public Employee Retirement Administration Commission (PERAC), the Commission will assemble a cost neutral package of reforms for new hires. Cost neutrality was the standard set by the Chair because the Commission had no information arguing for either an increase or a decrease in the total compensation for public employees. Cost neutrality could mean many things – the same projected dollar cost to the Commonwealth; the same normal cost payment by the Commonwealth; etc. For the purpose of this Commission, cost neutrality has two components – 1) the total normal cost of the system remains unchanged, and 2) the sharing of the normal cost between the Commonwealth and the employee reflects the distribution under current law. From this starting place, the legislature, as it sees fit, can adjust the recommendations by increasing or reducing the benefit package or increasing or reducing the portion of the normal cost paid by the employer.

The Commission's discussion went beyond the retirement system to consider retiree health insurance and whether the public employer's contribution to retiree health insurance should vary by years of service. Again, the Commission has not decided on a recommendation, but the proposal is included so that its cost impact can be determined. Retiree health insurance falls outside PERAC's domain and requires a separate procedure to estimate the impact of pro-rating on the budgets of Massachusetts' public employers.

To set the stage for the proposals to be costed by the actuary, a brief description of key features of the Massachusetts system follows.

III. The Massachusetts System²

Massachusetts public employees are covered by a defined benefit pension plan that is administered by 104 local retirement boards, the Massachusetts State Retirement Board, and the Massachusetts Teachers Retirement Board. PERAC oversees all boards, and all the systems are governed by Chapter 32 of the Massachusetts General Laws. As shown in Table 1, the system now includes almost 320,000 active workers and 190,000 retirees.

² For a complete list of benefits, see the PERAC "Massachusetts Public Employee Retirement Guide."

Table 1. *Participants in Massachusetts Public Employee Retirement System, 2009*

System	Participants		
	Active	Term vested	Retired
State*	86,529	3,663	50,873
Teachers**	89,788		52,107
Local***	142,454	1,250	86,166
Total	318,771	4,913	189,146

Source: PERAC.

* As of 1/1/09.

** Preliminary as of 1/1/09.

*** Based on date of most recent valuation, which varies by system.

GROUPS

The Massachusetts system consists of 4 classes of membership:

Group 1: General employees and teachers;

Group 2: Certain specified hazardous duty positions;

Group 3: State Police;

Group 4: Police officers, firefighters, and other specified hazardous positions.

ELIGIBILITY

A member is eligible for a retirement allowance (service retirement) upon meeting the following conditions:

- completion of 20 years of service; or
- attainment of age 55 if hired prior to 1978, or if classified in Group 4; or
- attainment of age 55 with 10 years of service, if hired after 1978, and if classified in Group 1 or 2.

AMOUNT OF BENEFIT

Retirement benefits are determined by a formula that multiplies the employee's length of service times average salary times a factor that is determined by age at retirement.³

Average salary is the average annual rate of regular compensation received during the 3 consecutive years that produce the highest average, or, if greater, during the last three years (whether or not consecutive) preceding retirement.

Group 1 employees receive an accrual rate that ranges from 1.5 percent of final salary at 55 to 2.5 percent at 65, with lower rates should a retiree (with sufficient service) claim before age 55. Group 2 employees reach an accrual rate of 2.5 percent at age 60, and Group 4 employees achieve an accrual rate of 2.5 percent at age 55 (see Table 2). State police have a separate system in Group 3 whereby they receive 75 percent of final pay after 25 years of service.

³ Massachusetts public retirement systems also provide ordinary and accidental disability retirement benefits for employees whose injuries are job-related and are not job-related and keep them from performing their employment duties. Benefits under accidental disability are 72 percent of pay at the time of injury. Benefits under ordinary disability are equal to a superannuation benefit based on service and salary at time of injury, applying the age 55 factor if the employee is under the age of 55.

Table 2. Benefit Accrual Rates

Age	Group		
	1	2	4
65	2.5	2.5	2.5
64	2.4	2.5	2.5
...		2.5	2.5
60	2.0	2.5	2.5
59	1.9	2.4	2.5
...	2.5
55	1.5	2.0	2.5
54	1.4	1.4	2.4
53	1.3	1.3	2.3
...			
41	0.1	0.1	1.1

Source: Commonwealth Actuarial Report, 2005.

DEFERRED VESTED BENEFIT

A participant who has completed 10 or more years of creditable service is eligible for a deferred vested retirement benefit. The participant's accrued benefit is payable commencing at age 55, or the completion of 20 years, or may be deferred until later at the participant's option.

WITHDRAWAL OF CONTRIBUTIONS

Member contributions may be withdrawn upon termination of employment. Employees who first become members on or after January 1, 1984, may receive only limited interest on their contributions if they voluntarily terminate their service. Those who leave service with less than 5 years receive no interest; those who leave service with greater than 5 but less than 10 years receive 50 percent of the interest credited.

TERMINATION BENEFITS

Employees with 20 years of service who are terminated involuntarily are entitled to an allowance equal to 1/3 of the member's 3-year final salary plus the annuitized balance of the employee's contributions, determined using a 7 percent return.

COST-OF-LIVING ADJUSTMENT

A cost-of-living adjustment (COLA) of up to 3 percent is paid on the first \$12,000 of a retiree's total allowance. Thus the maximum COLA is \$360 per year.

ANNUITY OPTIONS

A member may elect to receive his or her retirement allowance in one of 3 forms of payment.

- Option A: Total annual allowance, payable in monthly installments, commencing at retirement and terminating at the death of the member.

- Option B: A reduced annual allowance payable in monthly installments, commencing at retirement and terminating at the death of the member with potential for lump-sum payment to the designated beneficiary.⁴
- Option C: A reduced annual allowance payable in monthly installments, commencing at retirement and terminating at the death of the member. At the death of the retired employee, 2/3 of the allowance is payable to the designated beneficiary. If the designated beneficiary dies before the member, the payment “pops up” prospectively to the amount payable under Option A.⁵

CONTRIBUTION RATES

The Massachusetts system is funded by a combination of employee contributions, investment returns, and state or local funding. Employee contribution rates are based on the dates they joined the system (see Table 3).⁶ The rate for new hires has been raised repeatedly so that contribution rates within the system now range from 5 percent to 12 percent, depending on the date of hire.

Table 3. Contribution Rates in Massachusetts Public Employee Retirement System

Date of hire	Contribution rate
Pre-1945	0%
1945-74	5%
1975-78	7%
1979-83	7% + 2 % on portion of salary over \$30,000
1984-96	8% + 2 % on portion of salary over \$30,000
1996 ^a –present	9% + 2 % on portion of salary over \$30,000
Teachers who elected “Retirement Plus”	11%
Teachers hired after 7/1/01	11%
State police hired after 7/1/96	12% + 2% on portion of salary over \$30,000

a. The increase in rate became effective 7/1/96.

Source: *Commonwealth Actuarial Valuation Report, 2008*.

⁴ The lump-sum payment is the amount by which the member’s contributions plus interest exceed the annuity payments received.

⁵ The designated beneficiary cannot be changed once the member’s retirement becomes effective.

⁶ The State began to raise the employee contribution rate during the 1970s, but the Supreme Judicial Court ruled that the rate was part of a contract so that rate hikes were limited to new employees. Opinion of the Justices, 364 Mass. 847 (1973).

IV. Proposals to be Costed for the Commission

The proposals presented below were designed for new hires. Both fairness to current employees and legal restrictions limit the extent to which changes should be applied to current employees. However, as with the 2009 legislation, it may be appropriate to close some loopholes and correct badly-designed elements for at least some current employees. In addition, the Commission may propose to give current employees some cost-neutral options.

BENEFIT DESIGN

1. IMPROVE BENEFITS FOR SHORT SERVICE WORKERS BY REDUCING THE VESTING PERIOD FOR RETIREMENT BENEFITS (BUT NOT FOR RETIREE HEALTH BENEFITS) FROM 10 YEARS TO 5 YEARS OF MEMBER SERVICE.

Rationale: The existing vesting period of 10 years is longer than that for most other state plans. Shortening the vesting period to 5 years would better serve short service employees – particularly employees who enter public service when they are older.

2. IMPROVE BENEFITS FOR SHORT-SERVICE WORKERS BY PROVIDING INTEREST EQUAL TO THE ONE-YEAR TREASURY RATE ON ALL WITHDRAWN MEMBER CONTRIBUTIONS.

Rationale: Employees who leave public service with less than five years of service receive a refund of their contributions with no interest. Those who stay between five and ten years receive a small amount of interest, based on the rates paid on individual savings accounts at a sample of at least ten financial institutions. The current rate is 0.6 percent. Providing more substantial interest is important because Massachusetts workers are not accumulating any credits under Social Security while they work for the Commonwealth, and their state pension is not portable when moving outside the system.

3. ENCOURAGE LATER RETIREMENT AND LOWER SYSTEM COST BY REDUCING THE AGE FACTORS BY 0.125 PERCENT RATHER THAN THE CURRENT 0.10 PERCENT. SAMPLE FACTORS FOR GROUP 1 EMPLOYEES WOULD BE 2.5 PERCENT AT AGE 65 (UNCHANGED), 1.875 PERCENT AT AGE 60, AND 1.25 PERCENT AT AGE 55. SIMILAR CHANGES WOULD APPLY TO THE AGE FACTORS FOR GROUP 2 AND GROUP 4 EMPLOYEES.

Rationale: The factors used to determine a member's retirement allowance depend on the member's age at retirement. The reduction in the factors takes into account the fact that when a member retires at a younger age, the retirement benefit will be paid for a longer period of time. The current factors provide a subsidy to those members retiring at younger ages. In other words, the value of the benefit is greater at younger ages than at older ages. This proposal would reduce, but not eliminate entirely, the subsidy for early retirement.

4. INCREASE THE PERIOD FOR AVERAGING EARNINGS FOR BENEFIT FROM 3 TO 5 YEARS.

Rationale: A slightly longer averaging period reduces the incentive to inflate late career earnings and slightly reduces initial benefits, thereby freeing up resources to help finance a more adequate COLA and interest on contributions for those leaving early.

5. PRO-RATE BENEFITS ACCORDING TO THE NUMBER OF YEARS IN EACH GROUP.

Rationale: Pro-rating may make employees more willing to accept administrative positions towards the end of their careers, will prevent windfalls for people who have only a short period of service in a high group, and will reduce the ongoing pressure to reclassify jobs. Under the proposal, a person who has worked in Group 4 for 25 years and then changes to Group 1 and retires 5 years later with 30 years of service would receive a benefit based on 25 years of service in Group 4 and 5 years of service in Group 1. Alternatively, an employee who has worked in Group 1 for 25 years and then moves into Group 2 and retires in 5 years with 30 years of service would receive a benefit based on 25 years in Group 1 and 5 years in Group 2.

6. SYSTEMATICALLY REVIEW THE CURRENT CLASSIFICATION OF JOB TITLES AND CLARIFY THE DEFINITIONS FOR BEING IN EACH GROUP. REDUCE THE NUMBER OF GROUPS.

Rationale: The Chapter 32 classification system presents a number of problems for retirement boards, the legislature, and participants: 1) Lack of clarity leads to anomalies where people doing very similar jobs fall into different groups; 2) Classifying by job held at retirement, rather than prorating, can give a large payoff to people changing jobs late in their careers; 3) Basing benefits on final job creates a sense of inequity in that retirement benefits do not reflect the whole of the service provided by the employee to the Commonwealth; 4) No mechanism connects the move to a higher group with the need for more revenues into the fund; and 5) Procedures for moving from one group to another are cumbersome and confusing due to the ambiguity of the definitions.

7. TIGHTEN THE CAP ON EARNINGS FOR PURPOSES OF CONTRIBUTIONS AND BENEFITS TO 75 PERCENT OF THE FEDERAL LIMIT (\$245,000 IN 2009).

Rationale: Under the defined benefit plan, Massachusetts taxpayers bear the risk of swings in the market when investment returns diverge from the actuarially assumed rate. One result of this arrangement is that some public employees, who earn very high salaries, shift risk onto the average taxpayer, who has modest earnings. The proposed cap would limit the amount of pension assets that the average taxpayer would have to secure. The 75-percent cap would have been \$183,750 in 2009, indexed for inflation thereafter. This cap would have exceeded the income of all but 10 percent of Massachusetts households. High-wage employees would not make contributions on amounts above the cap, allowing retirement saving in a separate account.

8. INTRODUCE AN ANTI-SPIKING RULE, LIMITING THE INCREASE IN PENSIONABLE EARNINGS IN ANY YEAR TO NO MORE THAN 7 PERCENT PLUS INFLATION OF THE AVERAGE OF PENSIONABLE EARNINGS OVER THE PREVIOUS TWO YEARS. THIS PROVISION WOULD NOT APPLY FOR BONA-FIDE PROMOTIONS AND JOB CHANGES.

Rationale: A pension plan that bases benefits on only a few years of earnings generates a strong incentive for workers to raise earnings in those last years to earn a larger pension than is the system's basic intent. To limit such gaming, many public plans have anti-spiking rules. Among the largest state plans that make up the Boston College data base, 42 percent have anti-spiking provisions. Of the plans for workers not covered by Social Security, 47 percent have anti-spiking provisions.

9. REPLACE THE CURRENT TERMINATION BENEFITS WITH A BENEFIT STRUCTURE THAT BETTER MEETS THE SYSTEM'S GOALS. OPTIONS INCLUDE AWARDING 2 OR 3 MORE YEARS OF SERVICE WHEN DETERMINING BENEFITS, OR AWARDING 2 OR 3 MORE YEARS OF AGE. LIMIT ELIGIBILITY FOR TERMINATION BENEFITS TO THOSE TERMINATED AFTER AT LEAST 5 YEARS OF SERVICE IN THE SAME AGENCY OR TYPE OF POSITION.

Rationale: Currently employees with 20 years of service who are terminated at no fault of their own are entitled to a benefit equal to 1/3 of high three earnings plus an annuity from contributions. In most cases, the lifetime benefit is significantly larger than what the employee would have received if not terminated and declines with further increases in age and service. These outcomes do not seem consistent with the goals of the Massachusetts system. Only two other systems (DC Teachers and Montana PERS) widely offer termination benefits. These two plans award the terminated workers either more years of service or consider them to be older; either approach would be preferable to the current arrangement.

10. CONSTRUCT A REPRESENTATIVE SAMPLE OF EARNINGS HISTORIES TO ENHANCE ANALYSES OF THE ACTUAL WORKINGS OF THE CURRENT SYSTEM AND POTENTIAL CHANGES. UNDERTAKE A STUDY OF SWITCHING FROM A FINAL AVERAGING PERIOD FOR BENEFITS TO AN INDEXED CAREER AVERAGE.

Rationale: Short averaging periods for public employees have a long history. Before computers, the ability to keep records for more extended calculations was limited. Now it would be administratively feasible to shift to an indexed career average for new hires. The traditional systems have shortcomings in both fairness and incentives that can be avoided in a career average system. The United Kingdom has just switched to an indexed career average for civil servants. The Commission did not have the time or a readily available set of earnings histories for a careful evaluation and comparison of the current system with a career average system.

RETIREMENT SECURITY

11. IMPROVE THE POST-RETIREMENT COST-OF-LIVING ADJUSTMENT (COLA) SO THAT IT IS AUTOMATIC, APPLIES TO A REASONABLE BASE THAT IS INDEXED FOR INFLATION, AND IS APPLIED CONSISTENTLY ACROSS JURISDICTIONS.

Rationale: The existing COLA provisions provide up to 3 percent annually on a base of \$12,000. Since the existing COLA is limited to a fixed pension amount that is not indexed, the purchasing power of many members' retirement benefits erodes too much over time. To reduce the vulnerability of retirement benefits to inflation, the aspiration, subject to available financing, is to have the COLA base raised to \$18,000 and that amount adjusted annually for inflation.

12. INTRODUCE AN OPTION WHEREBY CURRENT EMPLOYEES COULD CHOOSE A LOWER INITIAL BENEFIT IN EXCHANGE FOR A MORE GENEROUS COLA ON A COST-NEUTRAL BASIS.

Rationale: Some current employees may be concerned about the extent to which their future benefits might be eroded by inflation and be willing to trade off a lower initial benefit for more inflation protection. Offering an actuarial equivalent option would not increase system costs but could increase the well-being of some members. To limit gaming based on the latest inflation forecast, this option could be available only to workers at least 5 years from eligibility for retirement and the window for choosing the option would be limited.

13. INTRODUCE A NEW ACTUARILY EQUIVALENT RETIREMENT BENEFIT OPTION THAT PAYS A CONSTANT PENSION STREAM FOR THE MEMBER AND HIS OR HER SPOUSE.

Rationale: The current system provides various types of annuities for both member and spouse, but it is not clear that these options are well-suited to the needs of all married couples. Many states offer an alternative that provides a constant benefit over the life of the retiree and beneficiary, and it could be developed to be actuarially equivalent to the existing options so as to not increase costs.

14. IMPROVE NOTIFICATION OF MEMBER'S SPOUSE WITH REGARD TO THE ANNUITY OPTION SELECTED BY THE MEMBER.

Rationale: Sending an additional notification letter, if first request for notification is not signed, would help ensure that the member's spouse is informed as to the type of annuity actually going into effect.

15. CLARIFY PENSION FORFEITURE LANGUAGE SO THAT EMPLOYEES DO NOT LOSE PENSION FOR MINOR MISDEMEANORS, BUT PRIMARILY FOR FELONY CONVICTIONS RELATED TO ONE'S EMPLOYMENT.

Rationale: Loss of pension due to minor misdemeanor seems excessive and causes increased administrative duties to the system.

**16. EMPLOYEES MADE INELIGIBLE FOR A PENSION DUE TO FORFEITURE, BUT WHO
CONTINUE TO WORK IN PUBLIC SERVICE, SHOULD NOT BE REQUIRED TO CONTRIBUTE TO THE
RETIREMENT SYSTEM.**

Rationale: If a member has been forced to forfeit his pension, it seems unfair to make that person continue to contribute to the system.

**17. ALLOW BOARDS TO RECOUP PENSIONS AFTER CONVICTION RETROACTIVE TO THE DATE
OF RETIREMENT.**

Rationale: Currently, pensions can be recouped retroactive only to the date of conviction. However, in some instances, members may retire in order to receive benefits in anticipation of imminent criminal proceedings. In those instances, boards should be able to require repayment of benefits received since retirement.

**18. MEMBERS WHO ARE ELECTED OR APPOINTED FOR A TERM OF YEARS UNDER M.G.L. C.
32 SECTION 5(1)(G) SHOULD BE REQUIRED TO REPAY ANY BENEFITS THEY RECEIVED WITH
INTEREST IN ORDER TO REJOIN THE SYSTEM, AND WORK FIVE YEARS IN ORDER FOR THEIR
BENEFIT TO BE RECALCULATED, CONSISTENT WITH THE PROVISIONS UNDER M.G.L. C. 32
SECTION 105.**

Rationale: This change would align the treatment of elected or appointed officials with that of other members.

**19. REMOVE THE TEACHERS' PROVISION WAIVING THE HOURS AND COMPENSATION LIMIT
FOR THOSE WHO WORK AFTER RETIREMENT.**

Rationale: The provision was initially enacted to prepare for a “mass exodus” of teachers under the “Retirement Plus” program. This mass exodus did not occur, and the system is currently providing waivers to about 80 educators per year. Treating teachers differently than other professionals that can be deemed in “critical shortage” status and treating professionals differently than non-professionals that can be deemed in “critical shortage” status creates inequities. Therefore, the provision should be removed.

**20. CALCULATE THE EFFECTIVE CONTRIBUTION RATE FOR EMPLOYEES CONTRIBUTING 9
PERCENT PLUS 2 PERCENT ON EARNINGS OVER \$30,000 AND CONSIDER INDEXING THE
\$30,000 THRESHOLD.**

Rationale: The \$30,000 threshold was introduced in the late 1970s and the additional contribution on earnings above this limit was intended to apply only to high earners. As earnings levels have risen, the majority now pay the additional contribution. Therefore, it is important to know how the structure affects the effective rate paid by participants and to consider whether the \$30,000 should be indexed so that the structure reflects its original intent.

SYSTEM FINANCING

21. DEFINE THE COMMONWEALTH'S CONTRIBUTION IN TERMS OF A PERCENT OF NORMAL COSTS SO THAT BOTH THE COMMONWEALTH AND CURRENT EMPLOYEES PAY MORE WHEN NORMAL COST INCREASES, THEREBY REDUCING THE SHIFTING OF THE BURDEN TO NEW EMPLOYEES. PERHAPS THE PERCENTAGES SHOULD DIFFER FOR DIFFERENT GROUPS.

Rationale: Of systems without Social Security, Massachusetts has one of the lower normal costs and one of the highest shares of normal cost paid by the employee. Moreover, under current arrangements, changes in normal cost from changes in life expectancy, interest rates, or any legislated improvements fall fully on the government or on future hires through further increases in contribution rates. Thus, workers doing the same job can have different levels of total compensation. Defining the Commonwealth's contribution in terms of a percentage of normal cost would mean that both parties would have to respond to evolving circumstances and could keep contribution rates uniform over employees with different future hire dates and so lead to a more equitable outcome.

22. REQUIRE MEMBERS RE-ENTERING THE SYSTEM PURCHASING PRIOR CREDITABLE SERVICE, AND THOSE ENTERING THE SYSTEM WHO ARE ELIGIBLE TO PURCHASE CREDITABLE SERVICE BASED ON WORK ELSEWHERE, TO MAKE THAT PURCHASE SOON AFTER ELIGIBILITY OR TO CONTRIBUTE MORE TO COMPENSATE THE SYSTEM FOR NOT HAVING ACCESS TO THEIR FUNDS FOR THE FULL PERIOD.

Rationale: Under existing law, a member re-entering the system or those purchasing service based on activities before pension membership may purchase prior creditable service by paying an amount equal to the accumulated regular deductions withdrawn plus interest or an amount related to earlier employment. However, some members are not required to make such a purchase within a certain period after eligibility to purchase is established. As a result, these purchases often take place immediately prior to retirement. This pattern has the effect of understating the liability associated with the member's service as well as reducing the investable assets of the system.

23. ALTERNATIVELY, REQUIRE MEMBERS RE-ENTERING THE SYSTEM PURCHASING PRIOR CREDITABLE SERVICE, AND THOSE ENTERING THE SYSTEM WHO ARE ELIGIBLE TO PURCHASE CREDITABLE SERVICE BASED ON WORK ELSEWHERE, TO CONTRIBUTE THE FULL ACTUARIAL INTEREST RATE.

Rationale: Under existing law, a member may purchase creditable service for work done elsewhere (for example, teaching in the public school system in another state, Peace Corps) by paying an amount equal to the accumulated regular deductions that would have been paid plus interest. However, the interest rate is 1/2 the actuarial rate. As a result, whenever these purchases take place the purchase has reduced the ability of the system to finance benefits.

24. MAKE ELIGIBILITY TO PURCHASE CREDITABLE SERVICE BASED ON WORK ELSEWHERE MORE CONSISTENT BY EITHER REDUCING THE CURRENT ABILITY TO PURCHASE OR EXTENDING IT TO SIMILAR CLASSES OF WORKERS WHO ARE EQUALLY DIFFICULT TO RECRUIT.

Rationale: The opportunity to purchase creditable years of service is a recruiting tool; the interest rate charged affects the size of recruitment generosity. Currently this opportunity is restricted to particular classes of new hires. It is not clear whether such differences in recruitment incentives are appropriate across positions with similar recruitment patterns.

25. REQUIRE ALL JUDGES TO CONTRIBUTE TO THE SYSTEM.

Rationale: The members of the Supreme Judicial Court do not currently contribute to their benefits. This exception is hard to justify in a contributory retirement system.

26. EXTEND THE CURRENT FUNDING SCHEDULE AND LIMIT THE ABILITY FOR SYSTEMS TO REDUCE FUTURE APPROPRIATIONS UNLESS WELL FUNDED.

Rationale: The recent financial crisis has seriously challenged the ability Massachusetts public employers to meet the payments required under the current funding schedule. Recent legislation extended the funding deadline from 2028 to 2030. A two-year extension, however, does not provide adequate flexibility for many Massachusetts public employers. In addition, current law has a number of anomalies that require attention. For example, it is silent as to what occurs when the system becomes fully funded and on how to amortize unfunded liability or surplus after 2030. To provide funding relief and to flesh out guidance, the PERAC Actuarial Advisory Committee recommends a new funding procedure. The new schedule allows for lower funding now, but also requires maintenance of effort when the stock market rebounds.

The unfunded liability will be amortized as follows:

- a. The full funding date will be extended so that the current unfunded liability and any additional amount accumulated over the next ten years will be fully paid off by a fixed date, which is no later than 30 years from the date the legislature allows the funding schedule to be extended, with a cap on the increase in amortization payments of 4 percent a year.
- b. Any *additional* unfunded liability attributed to experienced gains or losses after the initial ten years will be separately amortized within a 20-year period of its occurrence, again with a cap on the increase in amortization payments of 4 percent a year.

The funding schedule outlined above is subject to the following additional limits if the funding ratio is less than 90 percent:

- a. At the discretion of the Retirement Board, the increase in the appropriation from one fiscal year to the next will be limited to 8 percent.
- b. The appropriation cannot decrease from one fiscal year to the next.

Require an actuarial valuation at least every 2 years and legislative reviews starting in 2015 and every 5 years thereafter.

27. INCREASE RESOURCES FOR SYSTEM ADMINISTRATION.

Rationale: Some of the proposals presented above will require additional record keeping or processing on an ongoing basis. There are further startup costs in changing the record-keeping systems in order to handle changed rules. In addition, it would be helpful to assemble an adequate sample of complete earnings histories for better analysis of the existing pension benefit determination process and consideration of alternatives.

RETIREE HEALTH INSURANCE

28. PRO-RATE THE EMPLOYER CONTRIBUTION FOR RETIREE HEALTH INSURANCE BASED ON YEARS OF SERVICE.

Rationale: A general issue arises as to whether all retirees should receive the same level of benefits regardless of how many years of service they have or how many hours per week they have worked. Many other states have delinked retirement and health benefits and pro-rate the retiree health contribution that they make based on years of service as well as having different vesting rules for cash benefits and health insurance benefits. For example, some states pay 25 percent of the subsidy for people with 10 years of service and 100 percent of the subsidy for people with 25 years of service, with an increasing percentage between the two points.

29. CONTRIBUTIONS FOR THOSE ON ORDINARY DISABILITY WOULD BE PRO-RATED BASED ON THE YEARS OF SERVICE THEY COULD HAVE ACHIEVED AT THE NORMAL RETIREMENT AGE BUT FOR THE DISABILITY. THOSE ON ACCIDENTAL DISABILITY ARE EXCLUDED FROM THE PRO-RATING SCHEDULE.

Rationale: Disability retirement provides a specific case where the employee is not able to accumulate further service credits. Under the current pension system, disability retirees continue to accumulate service credit while on disability. To align the pension system in terms of fairness to workers with disability, the pro-rating of the employer retiree health care contribution will account for service accrued while on disability.

30. CONTRIBUTIONS FOR RETIREE HEALTH INSURANCE SHOULD BE CHARGED TO EMPLOYING JURISDICTIONS BASED ON THE PORTION OF THE EMPLOYEE'S SERVICE IN EACH JURISDICTION (SIMILAR TO THE PROVISION FOR PENSIONS).

Rationale: Employees may have spent only a portion of their career in the jurisdiction from which they retire, yet the jurisdiction of final employment is responsible for the full contribution to retiree health insurance. Pro-rating contributions based on time spent in each jurisdiction would allocate the cost more equitably across all the employing entities. Recognizing that jurisdictions pay varying rates toward retiree health insurance, it is

recommended that the lower contribution rate should apply for the purposes of the charge-back.

31. RETAIN ELIGIBILITY FOR RETIREE HEALTH INSURANCE AT 10 YEARS OF SERVICE.

Rationale: Contributions for retiree health insurance should be available only to longer service employees. Requiring longer vesting for retiree health insurance than for pension benefits is one way to achieve that goal. Different vesting periods for retirement benefits and health insurance contributions are common in other states.