Retirement Costs

The Public Employee Retirement Administration Commission (PERAC) is responsible for monitoring, advising, and regulating 105 Massachusetts public pension systems. Annually, PERAC issues a report of each system's status (e.g., retirement board membership, last valuation date, return on investment, funding ratios, and investment vendors used) for the previous calendar year.

Each public pension system is overseen by a retirement board, which is bound by a fiduciary duty to manage the system in the best interest of the members and their beneficiaries. Essential to that role is to ensure that resources exist to finance the retirement system benefits, such as pensions, guaranteed in G.L. Chapter 32. In this capacity, the board relies on actuarial analysis of the assets and liabilities to determine its funding obligation.

An actuarial valuation provides the amount of the system's assets and the actuarial approved liabilities as of a specific date based on assumptions that take into account past and anticipated experience (e.g., investment return, salary increase rate, and turnover). The funding schedule is derived from the valuation results. The funding schedule includes the normal cost (the amount of benefits expected to be accrued by active members in the current year) and an amortization on the payment of the unfunded pension liability (the difference between the actuarial accrued liability and the pension fund's assets) of the retirement system.

Based on the actuarial valuations, the unfunded pension liability and the funded ratio (the actuarial value of plan assets divided by the actuarial accrued liability) are determined. When a system's unfunded liability reaches $0 and its funded ratio reaches 100 percent, a system is said to be "fully funded" and is only required to make appropriations to cover normal costs. Based on the funding schedule, annual contributions to the system are made through assessments levied upon the public sector governing body units that participate in a system. Employees also contribute to the pension fund through payroll deductions. To help offset the impact of these assessments on state and municipal budgets, each retirement board makes management decisions about the investment of the system's assets. A retirement board may invest its own funds, hire investment managers, and/or participate in the state-run Pension Reserves Investment Trust (PRIT) fund.

Fluctuations in financial markets in recent years can dramatically impact public pension system assets. As each new actuarial valuation is completed, the value of the system's assets is determined. When the markets flourish, system assets grow, but when the markets experience a decline, those assets could decrease in value. If a retirement fund's return on investment is greater than the actuarial assumption, the unfunded pension liability will generally decrease. This assumes that the system does not incur actuarial loses on plan liabilities (e.g., wage increases greater than expected) or additional costs (e.g., adoption of an early retirement program). If there are gains, a retirement system may maintain its funding schedule and adjust its “fully-funded” date to be sooner than originally projected. Conversely, when the market results are less than actuarially projected or the retirement system assets lose value, the retirement board must take corrective action. To recover the loss, the retirement system may increase the assessments levied upon the participating member units or a retirement board may, with the approval of PERAC, revise its pension funding schedule and adjust the member units’ assessments within the maximum number of years left prior to the statutory deadline.

With growing retirement system costs and the associated impact on local finances, the financial and benefit structure of the systems, as created by G.L. Chapter 32, has been scrutinized. Four Pension Reform laws have been enacted to amend G.L. Chapter 32, addressing excesses, abuses and systemic problems and providing other changes that are prospective and designed to provide gradual cost savings for retirement systems. These changes are summarized in the table below.

Chapter 21 Acts of 2009	• Clarified definition of regular compensation • Addressed creditable service for elected officials • Established minimum compensation for creditable service • Revised dual member calculations • Extended funding schedules to 2030
Chapter 131 Acts of 2010	• Established a cap on pension earnings • Set an interest rate on returned retirement deductions
Chapter 188 Acts of 2010	• Extended funding schedule to 2040 • Increased COLA base • Established biennial actuarial valuation requirement • Allowed local option early retirement incentive (ERI) program
Chapter 176 Acts of 2011	• Enabled purchase of creditable service • Eliminated Section 10 termination allowances • Implemented Anti-spiking provisions • Pro-rated service in more than one job group • Increased retirement age eligibility • Increased average annual compensation period from three to five years • Increased normal retirement age by two years • Increased early retirement reduction (reduced age factors) • Updated retirement board investment restrictions • Instituted retirement board financial disclosure requirements • Mandated competitive bidding process for investment, audit, accounting and legal services to retirement boards

	• Instituted retirement board continuing education requirements • Required employers submit collective bargaining agreements to retirement boards

As of this time, all funds still have an unfunded pension liability. Furthermore, many cities and towns continue to face growing assessments with limited resources available to fund these fixed costs. Therefore, it is recommended that cities and towns consider the following when planning and managing retirement obligations.

- **Analyze the Impacts of Benefit Decisions** – Local decisions such as salary increases, other employee benefits granted, and early retirement packages have a direct impact on the community's current operating budget as well as future pension and other post-employment benefit costs (OPEB). Consequently, decision-makers should be informed of all current and future costs before taking action.

- **Consider Interim Actuarial Valuation in Off Year** – PERAC suggests that in between required biannual actuarial valuation of a retirement system that an interim valuation be done. An interim valuation may be built into an actuarial contract or may be done with assistance from the PERAC staff. An update of the funded status of the retirement system would involve using actual asset values in conjunction with estimated, rolled forward, prior year plan liabilities. This will enable the system to maintain more up-to-date data and ensures that funding schedules are in fact accurately addressing system liabilities. Having timely information enables decision makers to take corrective action when necessary.

- **Adopt Responsible Financing Plans** – Those systems that adopted aggressive funding schedules from the beginning generally are in a better position than those that deferred payments until the latter years. PERAC has found that the more successful systems have not reduced funding schedule levels, but rather have adopted more conservative measures when actuarial gains would allow a decrease in the annual appropriation. This action is prudent and provides flexibility in case of an economic downturn.

- **Consider Establishing a Pension Reserve Fund (G.L. c. 40, §5D)** – Despite revisions to a system's funding schedule, some communities have maintained the higher funding requirement, placing the revenues not required by the retirement system into an investment account. Establishing a Pension Reserve Fund enables the community to set aside funds designed to absorb dramatic assessment increases. As the custodian of such fund, the local treasurer may deposit the proceeds approved banking institutions or may participate in the PRIT Fund (http://www.mapension.com) in accordance with G.L. c. 32, §22.

- **Provide Accelerated Payment Options** – In a unique approach, Middlesex County Retirement Board has its actuarial study done by member unit. While this requires 70 separate studies, it may be characterized as a "fairer" allocation of the system's liabilities rather than on payroll. A secondary benefit to this approach is the ability of participating public entities to make accelerated payments that would be credited to the unit's separate account. These additional contributions would be invested in higher yielding instruments available only to retirement systems, and be applied to the community's individual unfunded pension liability.

- **Review Investment Performance** – It is the responsibility of the retirement board to be diligent in the oversight of the system's activities and results. In doing so, the board should compare its long-term investment performance with other systems' and that of the PRIT fund. If the system's performance is below the other systems, the board should review its investment strategies and/or consider participating/investing more in the PRIT fund.

For more detailed information and definitions, please refer to PERAC's educational materials such as *Actuarial Valuation Basics* and annual report archive.

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