



Letter from the Executive Director

It is nearly a decade since the Legislature adopted Chapter 306 of the Acts of 1996 which created the Public Employee Retirement Administration Commission (PERAC). Much has taken place in the years since, including a change in the manner in which COLAs are granted, the establishment of a process to enforce provisions of law regarding post-retirement earnings, and progress in the funding of our pension systems.

In that time, PERAC has had four chairmen. Paul Menton led the Commission in its early years as it established the organizational structure that exists today. Elizabeth Laing, whose untimely death robbed us all of her wise counsel and patient advocacy, presided over the years in which PERAC solidified its reputation as an objective source for analysis, opinion, and fairness. Robert Tierney built on that work and, through the extensive knowledge he had gained at DALA, he contributed to the Commission's comprehensive approach to issues. Judge Domenic J.F. Russo, our present chairman, has provided the leadership under which the Commission has achieved the accomplishments outlined herein. I would like to extend our thanks to all of these fine individuals whose dedication to public service has made a permanent contribution to the well-being, not only of employees, retirees, and beneficiaries, but to the Commonwealth itself.

In terms of changes in the Commission, we were recently notified that Commissioner Henry Brauer had resigned his position. Although Commissioner Brauer served on the Commission for a relatively short time, he brought his expertise to bear on a number of difficult issues and greatly contributed to the Commission's success.

During the course of 2005, some PERAC staff members left us to begin new phases in their careers and new personnel joined our agency. I extend my sincere thanks for a job well-done to those individuals whose service to PERAC has ended. It is a pleasure to welcome those staff members whose tenure has only recently begun. These newcomers join a group of professionals who have served the agency ably for a number of years. They are the Commission's pride. Every person on the PERAC team brings unique skills and abilities that contribute to our success. The importance of the integral role that PERAC plays in developing and establishing public pension policy is reflected in the commitment of the hard-working professionals who make up this agency. It is their contributions that are essential. On behalf of the Commission, I express our gratitude for their efforts.

Reform

Last year, we reported on the concerns facing pension plans across the country and how the Massachusetts public pension environment can be improved to address some of those concerns. In particular, the area of transparency in the management of the pension system is a common concern throughout the pension community. In addition, as always, the challenge exists to maintain and improve on investment returns in order to assist in the financing of liabilities.

With this in mind, and in light of recent developments, the Commission created the Reform Initiatives Advisory Committee, chaired by former Attorney General Scott Harshbarger, to review the law and regulation to give boards the tools to meet these challenges proactively. In the fall, the Committee filed its report. PERAC then sought the views of the Public

Last year, we reported on the concerns facing pension plans across the country and how the Massachusetts public pension environment can be improved to address some of those concerns. In particular, the area of transparency in the management of the pension system is a common concern throughout the pension community.

The Commission believes that the “waiver/exemption” process should be reviewed with an eye towards making it less onerous. This will enable the Commission to increase the emphasis on competitive process and fiduciary compliance. Such a reform requires more extensive statutory or regulatory guidance to the boards about the competitive process for vendor selection. The proposal recommends a procurement process similar to the one required in Chapter 30B for government procurement at the local level.

Pension Advisory Group (PPAG), a group comprised of board members and administrators that meets regularly with PERAC, about various aspects of the legal and regulatory framework. PERAC also held a series of open sessions throughout the state to gain input from board members, administrators, impacted parties, and the public. Following that process, the Commission again reviewed the proposals, made several changes, and forwarded statutory language to the Legislature’s Committee on Public Service.

The legislation focuses on the following:

First—Since the investment environment in which boards operate has remained essentially the same for the last 20 years, changes should be adopted to grant boards greater flexibility while insuring that assets are protected.

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The expansion of existing disclosure requirements for payments associated with obtaining business from a retirement board and enhanced penalties for failure to disclose would replace the exemption process. The annual filing of disclosure forms and the delineation of all payments to and from any service provider would be components of such a change.

PERAC would retain the ability to prohibit a particular investment if it is in the best interest of the system.

Second—If a retirement system is in fiscal or administrative jeopardy that necessitates quick (perhaps temporary) action to protect assets, or to ensure the members’ rights are secure, PERAC must be able to act.

We can all envision circumstances in which a municipality has failed to make contributions, or rogue investment managers have adopted a strategy that threatens the stability, or even the viability of the system.

Consequently, in conjunction with the expansion of board authority and the reduction of regulation in the investment area, mechanisms to allow for speedy remedial action, as well as deterrence of any threat to system assets are suggested.

Third—There are governance issues that have re-

cently come to the forefront that must be addressed. Board employees and vendors serving on boards clearly raise governance issues. There has been much discussion about the role of corporate directors, the need to avoid conflicts, and insure independence in the management of American corporations. Similarly, restrictions should be placed on board membership to avoid real or perceived conflicts.

Fourth—In light of some of the circumstances outlined above relative to vendors and disclosure of conflicts, the disclosure requirements for vendors and board members need to be changed.

Fifth—Along these lines, there is a need for financial disclosure by board members, similar to the reporting requirements included in the Financial Disclosure Statement filed by state policy makers. The amount of assets under management by boards and the complexities of the marketplace make the establishment of such disclosure a necessary tool. The goal is to not only address possible conflicts before they arise, but also to remove the perception of conflict of interest among system members, policy makers, and the public.

Sixth—Disciplinary action should be taken when a firm or individual providing services to the retirement boards is convicted of a crime related to procurement, or engages in practices that undermine public confidence in that firm’s ability to provide services. With the creation of a clear statutory process, necessary action could be taken while the rights of those involved are safeguarded.

On May 4, 2006, the Joint Committee on Public Service, chaired by Senator Patricia Jehlen and Representative Jay R. Kaufman, on a unanimous vote of members present, reported a strong pension oversight and governance reform bill that includes many of the provisions proposed by PERAC. We look forward to working with the Legislature as it considers this important measure.

Veteran’s Benefits

Legislation, approved in 2005, provided the additional veteran’s benefit of \$15 per year for each year of creditable service, up to a maximum of \$300 per year, to any Group 1, 2, or 4 member who is a veteran and who retires due to an accidental disability. The measure becomes effective upon local acceptance. In addition, the benefit can be made retroactive through action at the local level.

Military Pay

A measure has also become law that provides that counties, cities, and towns may pay an employee, who has been granted a military leave of absence because he or she is a member of the Army National Guard, the Air National Guard, or a reserve component of the armed forces called to active duty, an amount equal to base salary less any amount received for military service.

COLA Study

The retiree's association advanced, and the Legislature approved, a measure to direct PERAC to conduct a study of the cost associated with increasing the COLA base from \$12,000 to \$22,000. The study detailed the impact of increases in \$1,000 increments, thereby providing analysis of options available between \$12,000 and \$22,000. The *PERAC Report on Impact of COLA Base Increase* was issued in September 2005.

The report states, "COLAs are an important piece of sound pension plan design, especially for members who retire with long service. Defined benefit plans are designed to replace a certain percentage of a member's pre-retirement income. COLAs attempt to keep a retiree's benefit current with inflation over time."

Following a review of the *Report*, the Commission recommended that the COLA base be increased from \$12,000 to \$16,000. In addition, PERAC suggested that costs associated with that increase be funded through the existing funding schedule or a modification of the existing funding schedule. This decision was premised on the fact that the current COLA base has not kept up with pension inflation: the current base disadvantages the longer service employees and is not competitive with most other pension plans.

Regular Compensation

On several occasions in 2005, the Commission met to consider the issue of whether certain payments generally associated with salary augmentation plans qualified as regular compensation for inclusion in the calculation to determine a retirement benefit. In the fall, the Commission adopted a regulation setting forth a new definition of regular compensation. Following a series of hearings across the state attended by hundreds of interested employees and their representatives, changes were made, and the final draft was filed with the Secretary of State. The PERAC regulation became effective on April 7, 2006.

The Commission recognizes that the decision to adopt a new definition of regular compensation has caused controversy. We thank all of those who made presen-

tations or submitted statements for consideration as the Commission wrestled with this difficult issue. We believe the final resolution is a fair one and that it will insure that all employers and employees engaged in collective bargaining have a clear understanding of this issue as negotiations proceed.

New Mortality Tables

The Fiscal Year 2005 State Budget also directed PERAC to establish new actuarial equivalent factors to be used in the calculation of retirement allowances. This included the development of a new mortality table and interest rate to be used in the determining those factors.

The new actuarial equivalent basis is the RP-2000 Combined Healthy Table with 50% male and female rates and an interest rate of 7%.

The long saga related to the establishment of new mortality tables for use in the calculation of various retirement benefits was concluded with legislation that became effective on February 10, 2006. It allows retirees who selected Option A or Option B between July 1, 2004 and December 27, 2004 inclusive, or the surviving spouse of such a retiree, to select another option. Retirees who selected Option C during the relevant time period are not eligible to select a new option. The legislation also directs PERAC to establish a new mortality table on or before January 1, 2014, and every 10 years thereafter.

Group Classification Study

The Chairs of the Legislature's Committee on Public Service, Senator Patricia Jehlen and Representative Jay Kaufman, have recently appointed a "Blue Ribbon Panel on the State's Retirement Group Classification System." The charge of that panel is to examine the classification system of the Massachusetts pension plan embodied in Chapter 32 of the General Laws, compare that system to other public and private pensions systems and, if necessary, make recommendations for reform. PERAC serves on the panel which is expected to make a report by June 15, 2006.

Although the importance of the study is evident from the confusion about classification that exists in the mind of the public, policy makers, and even employees, the Commission is mindful of the fact that any changes in structure would need to be consistent with the contractual rights of employees established in Chapter 32.

In the past, the Massachusetts' pension community has allowed events to dictate its role rather than anticipating the need to modernize practices and procedures. One lesson learned from the past is that, in the absence of leadership from within, others with a different perspective on retirement and the appropriate role for retirement boards will drive the debate. Together we can shape change in a manner that is in the best interest of current and future beneficiaries of the retirement systems.

Interim Investigative Report

In October 2005, PERAC issued its *Interim Report—The Middlesex Retirement System & Cambridge Financial Management*. That report reviewed certain aspects of the investment that the Middlesex Retirement Board (MRB) made through Cambridge Financial Management (CFM). In 2003, upon the death of the principal of CFM, it was discovered that the account he managed on behalf of the MRB was confronted with \$37 million in losses. PERAC found that, although CFM had been retained to establish a currency overlay program to protect the MRB portfolio from fluctuations in the value of the dollar, over time CFM engaged in speculation that led to the losses. The *Interim Report* reviewed aspects of the investment and actions of parties involved including the MRB, CFM, Mellon, Goldman Sachs, and Wainwright Investment Counsel.

One element of the PERAC Temporary Order issued in relation to this matter was the requirement that the MRB conduct a fiduciary audit to assess its policies and procedures. On September 8, 2005, Independent Fiduciary Services presented its *Fiduciary Audit*

Report. The audit contains 91 recommendations and makes the following general observations, “(1) the need for governance enhancements (e.g. ensuring that the roles and responsibilities among board members, staff, investment consultant, etc. are clearly understood and articulated) and (2) the need for written documentation of policies, procedures, and current practices.”

Although the audit specifically reviewed the practices of the MRB, it is an instructive document for all retirement board members and contains many helpful recommendations that are worthy of consideration.

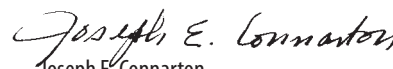
PERAC is continuing with its investigation of this matter and hopes to complete a final report in the near future.

Conclusion

As I noted at the outset, PERAC has been in existence for nearly a decade. During that time, all of those who have served as Commissioners have stressed that the agency’s mission must be founded on the need to

serve the retirement boards so that those boards can serve their members. Educational efforts, regulatory actions, legislative proposals, and all other activities of the Commission have been done with this goal in mind. Fundamental to that approach has been an attempt to be proactive, not reactive. In the past, the Massachusetts’ pension community has allowed events to dictate its role rather than anticipating the need to modernize practices and procedures. One lesson learned from the past is that, in the absence of leadership from within, others with a different perspective on retirement and the appropriate role for retirement boards will drive the debate. Together we can shape change in a manner that is in the best interest of current and future beneficiaries of the retirement systems.

Sincerely,


Joseph E. Connarton
Executive Director