



Letter from the Executive Director

We are pleased to present this Annual Report detailing the activities of the Public Employee Retirement Administration Commission (PERAC) and the Massachusetts public pension systems during 2006. Although we have already disseminated the investment return results for the systems, this report elaborates on that information and includes material related to other aspects of pension administration.

The Massachusetts public pension systems and the boards that are responsible for their management are at a crossroads. Governor Patrick's proposal to establish an investment and funding standard for the boards underscores the importance of pension financing in the overall fiscal health of the Commonwealth and its cities and towns. The interest generated by that recommendation may lead to improved and strengthened local pension systems, or it may ultimately lead to dramatic changes in the very structure that has served system members and taxpayers so well for so long. Which of these results is realized will be largely determined by the combined action of the entire public pension community in the months ahead.

PERAC Changes

Paul Doane was appointed to the Commission this past fall, replacing Henry Brauer. Commissioner Doane is a familiar face in the public pension community, having served as Executive Director of the Pension Reserves Investment Management Board (PRIM) in the early 1990's following a career in the State Senate. More recently, with the passing of one gubernatorial administration and the advent

of another, Commissioner Carlo DeSantis has been replaced by Mary Ann Bradley, Assistant Secretary for Administration, Executive Office of Administration and Finance. We thank Mr. DeSantis for his service and contributions and look forward to working with Ms. Bradley in the years ahead.

In November, the Commission re-elected the Honorable Domenic J. F. Russo as its Chairman. Judge Russo was first elected to complete the unexpired term of former Chairman Robert E. Tierney. Also, Sergeant James M. Machado of the Fall River Police Department was re-appointed to a second term as the representative of a public safety union on the Commission. We thank Chairman Russo and Commissioner Machado for their commitment to making the Commission the pre-eminent voice for public pensions in the Commonwealth.

Open House

In conjunction with the Commission's tenth anniversary, an open house was held at PERAC's offices in Somerville on November 30th and December 1st of 2006. Retirement board members and staff, legislators, actuaries, attorneys, academics, investment advisors, consultants, and custodians had an opportunity to tour the facilities and meet privately with Commissioners, administrators, managers, and staff. It was an enjoyable day for PERAC and we hope to institute a regular series of such events.

Reform

As we have reported in the past, the Commission filed legislation focusing on retirement board corporate

governance for consideration in last years' legislative session. That matter received a favorable report from the Committee on Public Service, but was not released by the House Ways & Means Committee prior to the end of the 2006 Legislative Session.

In anticipation of consideration of this legislation in the 2007 Legislative Session, at a meeting in December, PERAC staff and representatives of the Massachusetts Association of Contributory Retirement Systems (MACRS) agreed to several changes to the language that had been filed by the Commission. Most significantly, the Commission agreed to remove those provisions which authorized the Commission to take dramatic and immediate enforcement action by ordering an offending board to take or desist from some action. A recent hearing was held on the bill and we hope to see its passage this year.

The legislation focuses on the following:

- The Commission believes that the "waiver/exemption" process should be eliminated. This will enable the Commission to emphasize competitive process and fiduciary compliance. Such a reform requires more extensive statutory or regulatory guidance to the boards on the competitive process for selecting vendors. The proposal recommends a procurement process similar to that specified in Chapter 30B for government procurement at the local level.

The exemption process would be replaced by the expansion of existing disclosure requirements relating to payments associated with obtaining

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business from a retirement board and enhanced penalties for failure to disclose. The annual filing of disclosure forms and the delineation of all payments from or to any source for services provided to a retirement board would be components of such a change.

- There are governance issues that have recently come to the forefront that must be addressed. Board employees and vendors serving on boards clearly raise problems of governance. There has been much discussion about the role of corporate directors, the need to avoid conflicts, and ensuring independence in the management of American corporations. Similarly, restrictions should be placed on board membership to avoid real or perceived conflicts. Under the proposal, a prohibition on board membership would be in place for all individuals who are chosen to serve on a board after January 1, 2008. Board staff would be able to serve on a board other than the one by which they are employed.
- Along these lines, there is a need for financial disclosure by board members, similar to the financial statements that must be filed by state policy makers.
- 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.
- Mandatory education for board members must be instituted in order to assist members in meeting their fiduciary duty.

A discussion of legislative matters would not be complete without a mention of Governor Patrick's proposal which was contained in his Municipal Partnership Act. It would require the transfer of assets into the Pension Reserves Investment Trust (PRIT) if certain investment and funding standards are not met. The Commission has not taken a position on the legislation. In fact, at the Public Service Committee hearing on the bill, one Commissioner vehemently opposed its passage, while the Secretary of Administration & Finance enthusiastically supported its adoption.

Accidental Death Survivor Benefit Increase

Legislation was approved in 2006 that provided that systems which had previously accepted the local option to increase the supplemental dependent

allowance for children of accidental disability retirees could accept a local option to increase the benefit for surviving children of accidental death victims each year, in an amount equal to the state COLA.

Rights of Laid Off Police and Firefighters

Once again, the Commonwealth and its cities and towns face difficult financial times. In light of that circumstance, the Commission would like to remind boards and members of the rights established by Chapter 324 of the Acts of 1983 and Chapter 235 of the Acts of 1994. Chapter 324 provides that, upon local acceptance, certain police officers and firefighters terminated due to a reduction in force in 1981 and 1982, and who returned to work prior to July 1, 1983, may be awarded creditable service for the period during which the member was unemployed. Chapter 235 provides that, upon local acceptance, certain police officers and firefighters who were terminated due to a reduction in force, and subsequently reinstated to their former position within three years of such termination, may be awarded creditable service for the period during which the member was unemployed.

The relationship between these two measures is complex. Under section 2 of Chapter 235 of the Acts of 1994, a member who was terminated by a reduction in force in 1981 and 1982, and returned to service prior to July 1, 1983, is entitled to such creditable service, provided that the city or town accepted Chapter 324 of the Acts of 1983 prior to October 8, 1985. However, if the city or town did not accept Chapter 324 by that date, in order to receive creditable service for that time, the city or town must adopt Chapter 235 of the Acts of 1994, and the member must purchase the service by repaying the amount, if any, withdrawn at the time of termination, with regular interest, until the date of reinstatement and depositing an amount equal to the contributions that would have been made during the period of unemployment had the member been receiving the same level of compensation as was the case at the time of termination. Under the provisions of Chapter 324, the member need only repay the amount withdrawn at the time of termination, if any, with regular interest until the date of reinstatement.

Middlesex Retirement Board

Throughout much of 2006, the Commission was occupied with issues related to the Middlesex Retirement Board (MRB). Further investigation of the investment with Cambridge Financial Management took place, culminating in a public hearing last fall. On a different front, the Commission initiated proceedings in connection with the MRB's action regarding its building in Billerica. Several legal challenges to the Commis-

sion's authority with respect to that matter took place and PERAC's position has been upheld.

Nonetheless, the MRB took action in the late fall to transfer its assets to the PRIT Fund. That transfer was completed in February. In addition, Lawrence Driscoll resigned from the MRB and has been replaced. The board's building manager has also resigned.

GASB 45

Although not directly impacting the pension system, recent promulgations by the Government Accounting Standards Board (GASB) related to the disclosure and funding of health care liabilities for retirees is clearly of major concern to retirees, the state, and its municipalities who must meet these liabilities. The state has identified its potential liability as ranging from \$7 billion to \$13 billion, depending on the decisions as to whether and how to fund this liability. Similar potential liability confronts cities and towns.

Emerging Issues Forum

In June of 2006, the Commission hosted its third Annual Emerging Issues Forum entitled, "Ethical Dilemmas in Public Stewardship." Inspector General Gregory G. Sullivan headlined the event and was joined by nationally renowned ethics experts Dr. Sheldon S. Sternberg and David T. Austern, Esq., as well as governance specialist Dr. Dennis Logue and fiduciary attorney Alan P. Cleveland. Over 160 retirement board members, administrators, and vendors attended the forum. Sessions covered PERAC's governance legislation, ethical concepts and principles, the cost of unethical practices, management of conflicts of interest, and cases of ethical misconduct.

This is an appropriate place to remind boards that the State Ethics Commission conducts monthly seminars to review Chapter 268A, the state ethics law. Seating is limited and we urge you to contact the Ethics Commission at 617-371-9500 to enroll. In addition, local communities may request seminars.

PERAC's 2007 Annual Emerging Issues Forum, "Financing Retirement Costs: the Future Isn't as Cheap as It Used to Be," will be held June 26th at Holy Cross College. We urge board members, staff, and interested parties to attend.

Legal Decisions

In 2006, two major decisions of importance to the public pension community were issued. In the first, State Retirement Board v. Francis Woodward, the Supreme Judicial Court (SJC) ruled that the six year statute of limitations applicable to contracts does not prohibit a board from taking forfeiture action

pursuant to G. L. c. 32, s. 15 more than six years after a member's conviction. In District Court, a judge had overruled the State Retirement Board, determining that such an action was barred by the contract statute of limitations. The SJC found that specific language in section 15 removed board discretion in these matters and stated that, "it would be illogical to permit the board to accomplish by inattention or inaction what it is prohibited from doing as a matter of discretion."

The second ruling was made by the Contributory Retirement Appeal Board (CRAB) in Flynn v. PERAC, CR-04-722. CRAB affirmed the Division of Administrative Law Appeals (DALA) decision that Chapter 32 does not permit a board to accept a portion of a workers' compensation lump sum settlement that is less than the full amount attributable to weekly benefits. In this particular case, the board told an accidental disability retiree that it would accept 20-25% of the workers' compensation lump sum settlement in full satisfaction of the amount to be offset. As this did not comply with the statutorily mandated amount, DALA and CRAB found that such an agreement could not be entered into by the board.

840 CMR 1.03 Actions

Unfortunately, the Commission has been compelled to take action pursuant to 840 CMR 1.03 to remove two individuals from the boards on which they served or were employed due to violations of Chapter 268A, the state ethics law. Harry Gannon, Executive Director of the Maynard Retirement Board, and Peter Arlos of the Berkshire Regional Retirement Board, were found by the Ethics Commission to have violated the provisions of Chapter 268A. 840 CMR 1.03 states that "No individual who . . . has been found by the Ethics Commission or any court to have violated M.G.L. c. 268A, shall serve or be permitted to serve . . . as a member, administrator, officer, . . . employee . . . of a board." In addition, under the regulations, Mr. Gannon and Mr. Arlos are prohibited from serving as a fiduciary, trustee, custodian, counsel, agent, or representative of a board, and may not serve as a consultant, manager, or provider of services to a board, nor in any capacity that involves decision making authority or the control of the monies, funds, assets, or property of any system. Mr. Arlos is pursuing an appeal of his removal.

Firefighters Study

The Commission, due to its responsibilities in the disability area, has always taken an active role in the assessment of quality of life issues pertaining to members, particularly public safety members. Recently, a PERAC commissioned study entitled, "Emergency Duties and Deaths from Heart Disease among Firefighters in the United States," was

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published in the New England Journal of Medicine (Volume 356, Number 12).

That study found that firefighters may be subject to an increased risk of a cardiac event, depending on the actions being performed. The authors conclude that underlying problems may manifest themselves during fire suppression and other strenuous activities. Consequently, they have determined that risk factors, whether job-related or not, should be reduced in order to diminish such occurrences. Regular physical evaluations, as well as fitness and wellness programs, were alternatives that were reviewed.

Communications

PERAC has added a search engine to its home page. The Commonwealth's Information Technology Division made the Google search capability available to state agencies and we were happy to avail ourselves of the opportunity. A search can be instituted by using the button on the right-hand menu column on every page in PERAC's website. A search can be made within PERAC's website only or throughout the entire Mass.gov website.

In PERAC's continuing efforts to provide the most up-to-date and comprehensive information available

regarding rights and benefits under Chapter 32, we published a revised version of the "Massachusetts Public Employee Retirement Guide" in 2006. Copies may be obtained using any one of the following:

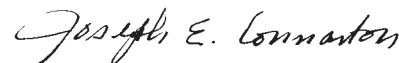
- (1) It may be downloaded for free at www.mass.gov/perac.
- (2) A member may request a copy from the retirement board.
- (3) Guides may be purchased at Central Reprographics, Room P-11, Plaza Level, McCormack State Office Building, One Ashburton Place, Boston.
- (4) Guides may be mail ordered from Central Reprographics. Consult PERAC's Home Page for pricing information or contact Central Reprographics via e-mail at cps@osd.state.ma.us or by phone at 617-720-3340.

Conclusion

As I noted at the outset, the public pension systems in the Commonwealth are at a crossroads. Nationally, the ongoing debate regarding defined contribution and defined benefit plans has served to raise the public's awareness of retirement plans without enhancing the public's knowledge of those plans. Closer to home, frustration with the pace of funding

liabilities combined with controversies, some of which are not directly related to the retirement plan, have increased scrutiny of the public pension community without context or perspective. For several years, the Commission has used this and other forums to encourage the retirement boards to take a proactive approach to these matters. Such action, even at this late date, can evidence a willingness to overcome our problems and 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