

Letter from the EXECUTIVE DIRECTOR

The Commission and its staff are pleased to release this Annual Report on the Massachusetts Public Employee Retirement Systems for 2011, a year in which the most far-reaching revision of our public pension statutes was enacted since the early 1980's. Reforms addressed the benefits available to present and future members of the retirement systems, the interaction between collective bargaining agreements and the pension law and the management of the pension systems by the retirement boards. The incorporation of many of the recommendations of the PERAC Reform Initiatives Committee into law marks a turning point for the public pension funds of Massachusetts. Enthusiastic compliance with those provisions will put to rest concerns about procurement practices, educational standards, and transparency that have contributed to the clamor for fundamental changes in the very nature of the Massachusetts' public pension funds and the benefits available to public employees in the Commonwealth.

Commission Changes

In September, Governor Deval Patrick appointed Alan Macdonald, President Emeritus of the Massachusetts Business Roundtable to the Commission. Alan formerly served on the Winchester Retirement Board and as an Assistant Attorney General. Alan's experience in both local government and the private sector provides the perspective of a business leader with direct knowledge of the challenges faced by retirement board members. That perspective has already added to the deliberations of the Commission and we anticipate working with Alan for many years to come.

Governor Patrick also reappointed Commissioner Jim Machado to the Commission. Jim has served as a police

officer in Fall River for 32 years. He has been a tireless advocate for the fair and sound administration of the retirement law and has made lasting contributions to achieving that end during his tenure.

Staff Changes

Staff changes also took place during the year as PERAC Investment Director Robert Dennis retired after serving 12 years in that position. Bob's extensive investment knowledge proved invaluable as the Commission addressed hedge fund investing, investment best practices and other issues. His regularly published commentary on investment matters was a "must read" for the public pension community. Tom O'Donnell has assumed many of Bob's duties as well as additional responsibilities as PERAC's newly appointed Compliance Officer.

In addition, Barbara Phillips retired after serving as PERAC General Counsel for over 25 years. Without the publication of a separate report, it is impossible to review all of the issues with which she dealt, the wise counsel that she dispensed and the professional example that she provided. Much has been said in the last several years about public employees and their commitment to service, there is no better exemplar of the best qualities of someone dedicated to that service than Barbara. John Parsons has succeeded Barbara as PERAC General Counsel.

Emerging Issues Forum

In September PERAC held its seventh Emerging Issues Forum at the College of the Holy Cross. Two hundred and sixty-two attendees heard Lieutenant Governor Tim Murray review pending pension reform legislation and Auditor of the Commonwealth Suzanne Bump discuss recent

audits that touched upon retirement concerns as well as the need to maintain public confidence in the system. The Forum also focused on the topic of pension funding and reporting standards. Steve Lemanski, Consulting Actuary from Milliman, discussed proposed GASB changes for pension accounting and financial reporting. Barbara Novick, Vice Chairman of BlackRock, reviewed pension investment, the impact of pension reform on municipal funding and Congressional emphasis on transparency and funding of public pension funds. She noted, in a comment that struck a chord with attendees, "Headlines do not tell the whole story." An exciting panel, moderated by PERAC Actuary Jim Lamenzo, addressed the topic of whether the future is a challenge that public pension systems can meet or must fundamental changes take place in the benefit structure and funding of these systems in the years ahead. Michael Widmer, President of the Massachusetts Taxpayers Foundation and Rebecca Sielman, Principal and Consulting Actuary of Milliman participated. Mr. Widmer focused on the financing of pension costs in an era of limited means and detailed the impact of retiree health care on public resources. Ms. Sielman provided an assessment of the financial condition of public plans in Massachusetts and Connecticut and concluded that, in Massachusetts, public policy makers have taken a responsible approach to funding these obligations. Jim Lamenzo wrapped up the Forum with a presentation of the post-2008 trends in liability and asset growth among the Massachusetts funds.

Technology

From its inception PERAC has tried to assist the retirement boards in implementing strategies to maximize the use of new technology. Last year we started a documents exchange pilot project involving the use of

a Web-based application for the secure electronic exchange of documents and files with the State Retirement Board. Based on the success of that project PERAC has expanded the use of the Secure File and E-Mail Delivery Application (commonly referred to as SFED) to exchange disability-related documents with other interested retirement boards. That system is fully operational. If your retirement board is interested in sending Medical Panel Requests and disability transmittal documents to PERAC electronically via SFED, please contact Paul Laliberte at prlaliberte@per.state.ma.us.

SFED is the best and most secure method of exchanging data with PERAC. Retirement boards may now use it to send their member, retiree and disability files to the Actuarial Unit instead of mailing them. To date, 60 boards have contacted John Boorack to establish an SFED account. Those boards not yet participating should contact John at JBoorack@per.state.ma.us to set up an SFED account. Departmental SFED accounts are now running for the Actuarial, Disability and Legal Units. In addition, each PERAC auditor now has an SFED account.

2011 Pension Fraud Prevention Campaign

In 2011 PERAC launched the agency's seventh campaign against public pension fraud since 1998. The campaign features a poster designed to heighten public awareness about pension fraud, and promotes a toll-free hot line and an email address to report instances of suspected pension fraud.

The PERAC fraud prevention campaign has evolved from the agency's oversight of the post-retirement earnings and medical condition of disabled public retirees throughout the state. Since the agency's inception, PERAC has identified over \$21.8 million paid to disabled retirees who have earned more income than what is allowed by state law. PERAC's efforts have enabled retirement boards and employers to recoup a portion of such "excess earnings." PERAC also administers a unique restoration to service program which involves the review of the medical condition of Massachusetts' disabled public employees to determine if they are physically fit to perform the essential duties of their former jobs. Approximately \$28 million has been saved that would have been paid in pension benefits to such retirees had they not returned to service.

Placement Agent Policy

Consistent with the theme of transparency, PERAC's Placement Agent Policy is now in effect. In conjunction with the investment and procurement provisions discussed below these steps establish a line of defense against charges of hidden interests. Vendors are submitting placement agent statements detailing relationships with those that act as a "finder, solicitor, marketer, consultant, broker or other intermediary in relation to

the investment of assets of Massachusetts public pension systems, including any person or entity which provides proactive consultant services concerning the changing political and policy environment in New England and nationally as it relates to retirement plans, notwithstanding the description of such services as informational consulting services only not involving the referral of investment advisory services."

Shift Substitution

Shift substitution is a common practice across the state and can be a valuable tool in certain professions. In particular, public safety professions need full staffing at all times, causing some departments to require that time off be taken in two-week increments, and a member cannot take a day off here and there as the need arises.

Where shift substitution occurs, there must be safeguards in place to assure that an individual, prior to retirement, has "repaid" all shifts owed by him. The retirement board must request and receive documentation that the member has actually worked the requisite number of shifts in a calendar year to qualify for all regular compensation and creditable service claimed.

Attorney General's Regulations on Remote Participation

The Attorney General has promulgated regulations regarding remote participation at meetings of public bodies. As a result, a retirement board can vote to allow remote participation by a simple majority. Once adopted, the practice will apply to all meetings held after that date unless and until the board revokes it. A quorum of the board, including the chairman or a person authorized to chair the meeting, must be physically present at any meeting during which a board member participates remotely. The permissible reasons for remote participation are personal illness; personal disability; emergency; military service; or geographic distance. All votes taken during any meeting in which a board member participates remotely shall be by roll call vote.

Chapter 176

Chapter 176 of the Acts of 2011 and the Commission's implementation of its provisions will be discussed below. However, one of the most significant aspects of that law relates to substantial changes in the benefit structure for those who become members on or after April 2, 2012. Retirement boards must make sure that those who are members on or before that date are aware of the ramifications of taking a refund of retirement contributions in the event they leave service. Such an action will terminate membership in the system and if he or she later returns to service on or after April 2, 2012 having taken such a refund, that individual will be considered a new employee and will be subject to the post-April 2, 2012 benefit structure. Benefit changes will include a new age factor table requiring a longer work period

before achieving the same or similar benefit available to pre-April 2 members; an increase in the period for determining regular compensation from three to five years; and an increase in the minimum retirement age.

Investment Under Chapter 176

The reform law simplified the regulatory requirements for retirement boards to follow in investing system assets. This approach is in keeping with the general thrust of the governance sections of the new law and recognizes the investment experience gained over the last 26 years by retirement board members. The documents which must be received and acknowledged by PERAC prior to investment of funds with a manager include:

- (1) a certification, signed by the board chairman, that, in making the selection, the board has complied with the procurement process established in section 23B;
- (2) a copy of the vendor certification as required under section 23B that its submission was made in good faith and without fraud or collusion;
- (3) copies of disclosure forms submitted by the selected vendor;
- (4) a certification that the investment is not a prohibited investment as set forth in regulations of the Commission;
- (5) a copy of the consultant reports pertaining to the investment and the selected vendor; and,
- (6) a copy of a board member form signed by each board member certifying that, to his/her knowledge and belief, the proposal of the vendor selected has been made in good faith and without fraud or collusion.

The Commission is authorized to "...withhold acknowledgement if it determines it is in the best interest of the retirement system." A similar process exists for the hiring of consultants.

The regulatory emphasis of the Commission will focus on the retirement board's compliance with its fiduciary duty, meeting the requirements of Chapter 176, particularly the procurement process of Section 23B, and the various disclosures mandated by the statute and the Commission's Placement Agent Policy.

Section 23B requires that each contract with an "investment service provider" include certain mandatory terms and conditions. These provisions must be incorporated into an RFP and agreed to by the contractor as part of that process. The term, "investment service provider(s)," includes, but is not limited to, managers, partnerships, trusts, custodians, consultants, as well as those providing proxy services, services related to the financial information retirement boards must file with PERAC, securities litigation services and other services which are investment related.

Contracts with such providers must include terms stating that: the contractor is a fiduciary with respect to the funds which the contractor invests on behalf of the retirement board; the contractor shall not be indemnified by the retirement board; the contractor is required to annually inform the commission and the board of any arrangements for compensation or other benefit received or expected to be received by the contractor or a related person from others in connection with the contractors' services to the retirement board or any other client; the contractor is required to annually disclose to the commission and the retirement board compensation, paid or expected to be paid, directly or indirectly, by the contractor or a related person to others in relation to the contractors' services to the retirement board or any other client; and the contractor is required to annually disclose to the commission and the retirement board any conflict of interest the contractor may have that could be expected to impair the contractor's ability to render unbiased and objective services to the retirement board.

Statement of Financial Interests Filing

In accordance with Chapter 176 retirement board members were required to file Statements of Financial Interests (SFI) for 2011 by May 1, 2012. These submissions are not subject to release pursuant to the public records law. Because of the confidential nature of this information I cannot provide details regarding this issue. However, I would like to commend the retirement board members for their willingness to meet the requirements of the new law. The first year of any initiative is always challenging and even more so when the subject is not only sensitive but beyond the past experience of most of those newly required to file.

The Commission has adopted Security Protocols to ensure that the information remains confidential. The staff at PERAC with access to the filings will be strictly limited. Initially only the Compliance Officer and Compliance Counsel will have access. In the event that an issue arises regarding compliance, the General Counsel and Executive Director as well as the Commission, in certain circumstances, will also be able to review a filing. If a Commissioner wishes to access a filing in the absence of those circumstances he or she must notify the Chair and may review the information in the presence of the Compliance Officer or Compliance Counsel. In the event that a Commissioner does so or if the Commission does so in the circumstances described above the retirement board member will be notified. Statements will not be copied or scanned electronically with the exception that a copy may

be made in order to provide the retirement board member with a date stamped receipt.

PERAC has also addressed how the Compliance Officer and Compliance Counsel will review compliance. That process will take place in several stages and retirement board members will be provided ample opportunity to establish that compliance with the statute has taken place or to bring the submission into compliance, if necessary.

Education Update

Chapter 176 includes provisions mandating that retirement board members complete training during each year of service on the retirement board. During each member's term on the retirement board, the member must complete 18 hours of training. This requirement took effect for calendar year 2012.

The kick-off event was a program on the Annual Statement on January 24, 2012. Two other sessions were held at PERAC and similar training was conducted in West Springfield. Dave Giannotti, Public Education and Communications Division Chief of the State Ethics Commission, conducted an educational session at the PERAC offices and also made a presentation at a meeting hosted by the Adams Retirement Board.

In the first several months of 2012 the Commission has sponsored or sanctioned ten educational sessions. These events have been held across the state from Adams to Wellesley and have focused on a variety of topics. Thus far 200 attendees have participated in these sessions. Although some of the 200 represent the same member attending one or more sessions that number is an indicator of our progress to date.

PERAC has also begun the process of authorizing credit for participation in programs sponsored by national organizations. Those attending the National Conference on Public Employee Retirement Systems (NCPERS) Trustee Educational Seminar received four hours of credit, thereby meeting the statutory requirement for 2012. Thanks to Hank Kim, Executive Director of NCPERS, and President Denis Devine and Vice President Chet Riley of the Massachusetts Association of Contributory Retirement Systems (MACRS), for assistance in making these arrangements.

MACRS June Conference

In addition, PERAC and MACRS agreed that educational sessions for credit would be offered as part of the MACRS Conference held in June. On Wednesday, June 6, 2012,

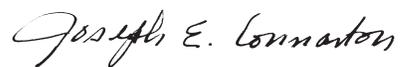
PERAC presented three hours focusing on Section 15 forfeiture, benefit calculations, and actuarial valuation basics and funding strategies. MACRS provided three hours of education for credit during the Conference covering securities litigation, fiduciary risk mitigation best practices and the Public Records Law.

As we schedule our program for the second half of this year we hope to arrange for seminars in other areas and during the evening.

Conclusion

The breadth and depth of the changes in the public pension landscape which took place in 2011 is formidable. Although, perhaps Chapter 176 had the most dramatic impact, other developments may, in the long run, have a greater role in the survival of the defined benefit system in Massachusetts. Foremost among these has been the steady progress made in overcoming the fiscal strain created by the failure of the capital markets in 2008 and the choppy economic recovery since then. Retirement boards and PERAC Actuary James Lamenzo have balanced the need to ensure that liabilities are addressed over time with the recognition that state and local budgets must meet a variety of needs. All systems are meeting responsible funding schedules tailored to the specific circumstances of the governmental units involved. As the investment results detailed in this report underscore, the returns achieved by Massachusetts' funds remain competitive with those of other pension investors nationwide. Long-range returns support the conclusion that retirement boards have responsibly managed system assets. Finally, retirement board members have once again displayed their dedication and professionalism in complying cooperatively and enthusiastically with Chapter 176. For that response, as well as their day-to-day, year in and year out efforts on behalf of system members, beneficiaries and taxpayers, I offer the Commission's heartfelt thanks.

Sincerely,



Joseph E. Connarton
Executive Director