

## REMEMBERING SENATOR KENNETH J. DONNELLY



Senator Kenneth J. Donnelly  
Testifying before Joint Committee on Public Service

By Joseph Connarton  
Executive Director

We are tremendously saddened by the death of our former Commissioner and Senator Kenneth J. Donnelly. As you know, Ken was the consummate public safety officer, PERAC Commissioner, and member of the Massachusetts Senate. Unfortunately approximately 8 months ago Ken was diagnosed with a brain tumor and he fought hard to get back to full strength after treatment.

Ken was most recently the Senate President's designee to the Pension Forfeiture Commission created last year to address the inequitable application of Section 15 of Chapter 32. He attended and actively participated in each meeting of the Commission right up until February of this year. The fact that some public employees who had committed a crime received a pension benefit while others did not bothered him greatly. We all know how hard he fought for benefits for public employees as a firefighter,

Secretary-Treasurer of the Professional Fire Fighters of Massachusetts, member of PERAC and valued member and leader of the Massachusetts Senate. He championed many causes during his career, including increasing access to quality mental health services, protections for homeless families and caring for retirees on fixed incomes.

Senator Donnelly represented the 4th Middlesex District, rising to the position of Assistant Majority Leader. His Senate career followed a 37 year career as a member and Lieutenant in the Lexington Fire Department.

As Cindy Friedman, Ken's Chief of Staff, said so well, the Senator never sought the accumulation of personal credit, but rather was dedicated to the causes he believed in and the people he represented, and he brought tremendous energy, courage, and passion to changing many lives for the better.

On behalf of the PERAC Commission and its staff, I can tell you Cindy was spot on with her assessment. In his death, let Ken continue to serve as a role model for all of us who continue to serve in government and remember him for the giant he truly was for so many, especially his beloved family, wife Judy, sons Ryan and Keith, and daughter Brenna.

On behalf of all of us here at PERAC, I say well-done good and faithful servant, well done! ■

## SELECTING THE INVESTMENT RETURN ASSUMPTION

By James Lamenzo  
Actuary

A 2013 Pension News article noted, "The investment return assumption is the most commonly discussed pension plan actuarial assumption. Almost every day, articles cross my desk about this assumption in Massachusetts and across the country. Many weigh in on the appropriateness of this assumption and claim the current assumption is too high." Despite reductions in this assumption over the past four years both in Massachusetts and across the country, the sentiment concerning the need to reduce the assumed rate continues to be expressed.

PERAC began performing local system actuarial valuations in the early 1990's. From that time until 2012, the most common or "standard" PERAC investment return assumption used in our local valuations (assuming a reasonable investment allocation) was 8.0%. In the late 1990's, pressure built to increase this assumption, but we maintained the 8.0% rate. About 2004, based on projected investment returns and national trends, PERAC began advising boards that we felt an

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## PUBLIC SERVICE COMMITTEE CHAIRS NAMED

Representative Jerald A. Parisella Appointed House Chairman



Representative Jerald A. Parisella  
Chairman, Joint Committee on Public Service

*By Michael DeVito,  
Director of Public Affairs*

The Massachusetts legislature has named its Co-Chairs of the Joint Committee on Public Service for the 2017-2018 legislative session. Senate President Stanley Rosenberg re-appointed Senator James E. Timilty of Walpole as Senate Co-Chair of the Committee and House Speaker Robert A. DeLeo appointed Representative Jerald A. Parisella of Beverly to be the House Co-Chair of the Committee.

Representative Parisella is in his fourth term in the House of Representatives. He is a graduate of Emerson College and also holds a J. D. from the New England School of Law. He has served in the House since 2011. Chairman Parisella previously served as the House Chairman of the Joint Committee on Veterans and Federal Affairs. He is a major in the United States Army Reserve serving as a Judge Advocate General and has served in Bosnia (1997) and Iraq (2011).

Senator Timilty has since announced he will be stepping down from the Senate

to become Norfolk County Treasurer, replacing Joseph Connolly. As Treasurer he will serve as Chairman of the Norfolk County Retirement Board. A new Senate chair will be appointed.

Representative Parisella and his Senate counterpart will chair the numerous committee hearings on hundreds of bills impacting pensions, health care and related issues during the session. These bills will remain active until the end of the current legislative session in January, 2019. PERAC monitors all bills impacting the Massachusetts pension system, retirement and related issues.

PERAC's Executive Director Joseph E. Connarton welcomes the new Chairman and congratulates Senator Timilty:

I want to congratulate Chairman Parisella on his appointment as House Chairman of the Joint Committee on Public Service. This is an important committee impacting not only the tens of thousands of state, municipal and other public employees in Massachusetts but also tens of thousands of retirees of Massachusetts' 104 retirement systems.

PERAC enthusiastically serves as a resource to the legislature and its committees on issues impacting pensions and retirement. We have already established a warm working relationship with Chairman Parisella and his staff and look forward to a continued close working relationship with the Chairmen and members of the Joint Committee on Public Service.

I would also like to thank Senator Timilty for his many years of service to the Committee and wish

## PERAC MEETS WITH THE JOINT COMMITTEE ON PUBLIC SERVICE

Overview of Key Pension Issues presented to the 2017-2018 Committee

*By Michael DeVito  
Director of Public Affairs*

On Wednesday, March 22, 2017 a delegation from PERAC met with recently appointed House Chairman Representative Jerald A. Parisella, Vice Chairman, Rep. Jay D. Livingstone and several other Committee members: Senator Donald F. Humason, Jr., Representative Chris Walsh, Representative Paul A. Schmid, III, Representative Daniel Cahill, and Representative Jack Lewis and Committee staff including, Robert McLaughlin, Chief of Staff to Senator James E. Timilty, Senate Chair of the Committee; Angel Donahue-Rodriguez, Chief of Staff to House Chairman, Representative Jerald A. Parisella; Cameron Doherty, Committee Research Analyst and Thomas Statuto, Legal Counsel to the Committee. Representing PERAC at the meeting were presenters: Executive Director Joseph E. Connarton and Actuary James Lamenzo; and also Michael DeVito, PERAC's Public Affairs Director. ■

him all the best as he assumes his new duties as Treasurer of Norfolk County and Chairman of the Norfolk County Retirement Board. We look forward to working with him in this new capacity. ■

## PROSPER SYSTEM NOW AVAILABLE TO BOARDS

By *Natacha Dunker*  
*Communications Director*

After several weeks of training sessions for the Compliance component of the application, PROSPER officially launched on Tuesday, April 25th. In total, 101 administrators and 96 board members attended the various training sessions.

We have been onboarding retirement systems on a rolling basis since the launch to ensure the smoothest transition possible. We wanted to have enough staff on hand to assist anyone with questions or technical guidance as they began to use the system.

Out of the 104 retirement systems, 87 have submitted their account approval forms. All boards that submitted approval forms have had registration links sent to them. Approximately 60% of those individuals

have registered. If the registration link you were sent expired, please contact the help desk at PER-ProsperHelp@per.state.ma.us or 617-591-8983. The good news is that those who have registered are already successfully using the system.

After seeing how user friendly the system is during the first round of training, many participants wanted to know when the Disability component would be released. The development team has been working hard with the PERAC Disability Unit to put in as much functionality as possible into this next phase, and we are pleased to announce that training for board administrators will be starting this month!

The training sessions have been divided according to retirement systems' size and location. The Boston Retirement System has agreed to participate in our pilot training session and invitations have been sent

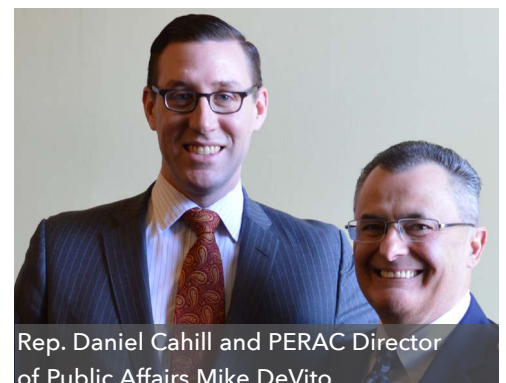
to the remaining retirement systems advising of their training dates and location. Kate Hogan, PERAC's Manager of Medical Services, will conduct this training, which has been designed for administrators and goes through the process of submitting a disability retirement application through PROSPER, from start to finish.

We expect the Disability component to be released in June. Please contact the PROSPER HelpDesk if your board administrator has not received an invitation to a training session. The full PROSPER project and launch will be completed by the end of the year. ■

### Project Schedule:

- ▶ April – Compliance (In Process!)
- ▶ June 2017 – Disability
- ▶ November 2017 – 91A and Finance Applications

## PERAC MEETS WITH THE JOINT COMMITTEE ON PUBLIC SERVICE



## SELECTING THE INVESTMENT RETURN ASSUMPTION *(Continued from page 1)*

8.5% assumption was too high. Beginning in 2010, based on projected returns after the 2008 economic downturn, we advised that we felt 8.25% was too high. Generally, the rate was reduced from 8.0% to 7.75% in PERAC's 2013 local actuarial valuations. We recommended further reductions (below 7.75%) in our 2015 valuations and 7.5% in 2016. This article focuses on the rationale behind the recommendation for 2017 local valuations.

Our analysis primarily concerns systems with most or all of their assets with the Pension Reserves Investment Trust (PRIT) system. For non-PRIT systems, we often recommend a lower assumption to reflect generally more conservative investment allocations.

The first two charts below show how this assumption has changed for Massachusetts public plans since 2003. Chart 1 shows the investment return assumptions for

Massachusetts public plans in 2003, 2012 and as of March 2017 (current). Chart 2 shows a more detailed breakout of the current assumptions. Chart 3 (the most recent National Association of State Retirement Administrators (NASRA) Public Fund Survey) outlines the assumptions for 127 large public plans around the country. Most of these plans are state and teacher plans although the chart also includes some large city plans. *(Continued, next page)*

Chart 1

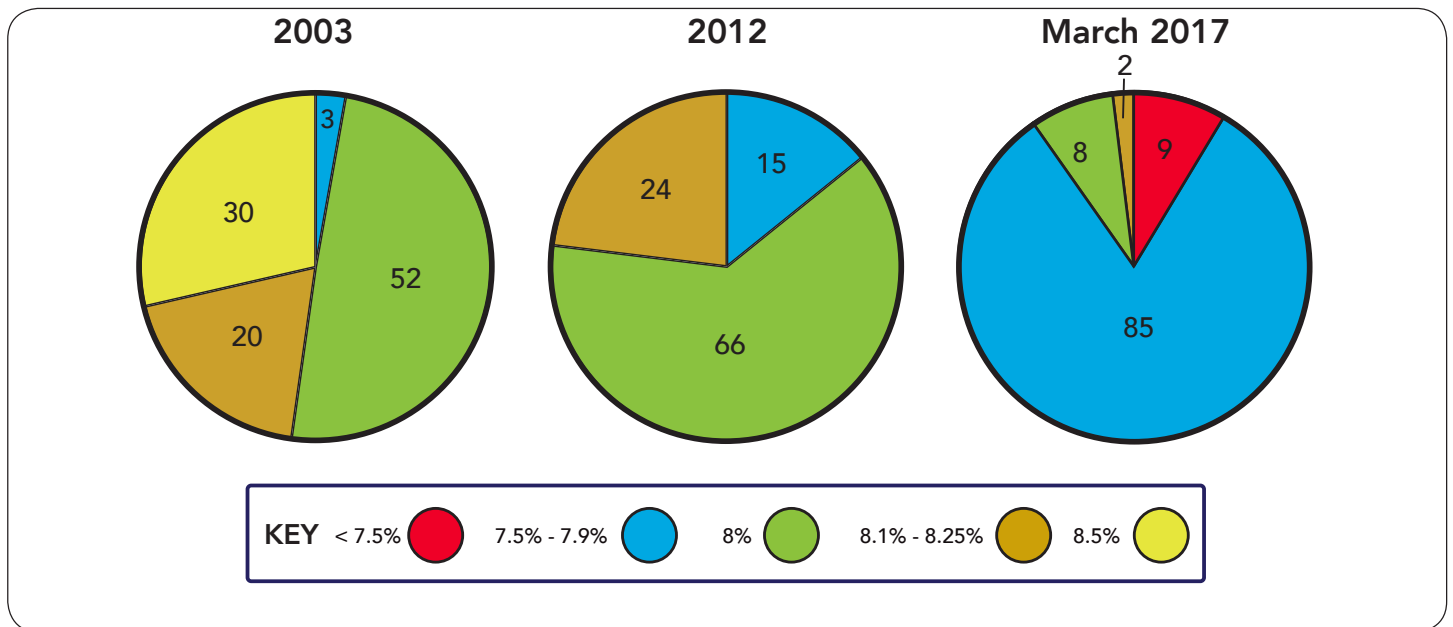
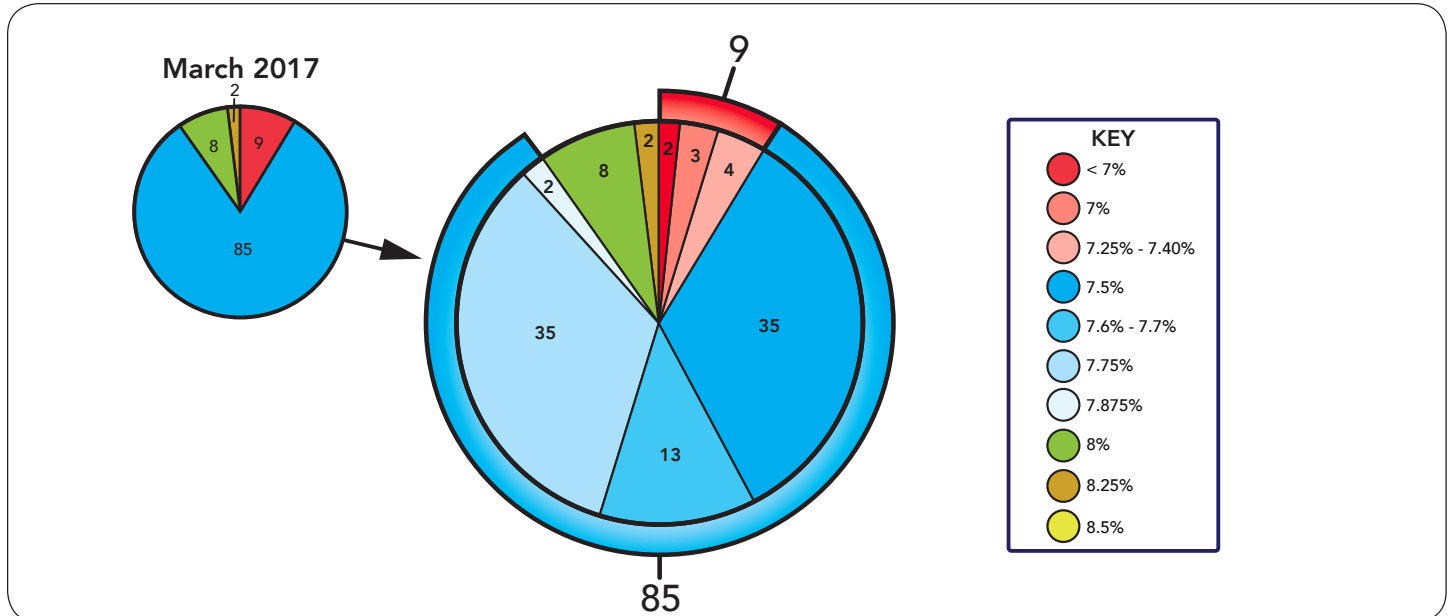


Chart 2



## SELECTING THE INVESTMENT RETURN ASSUMPTION

Several items stand out in these charts. In 2003, about half of Massachusetts systems used an investment return assumption above 8.0%, with most using 8.5%. Today there are only 2 systems using an 8.25% rate. In 2003 only 3 systems used an assumption less than 8.0%. Currently there are 94 such systems.

The changes from 2012 are significant as well. By 2012, no system used an 8.5% assumption; however, about 25% of systems were still above 8.0%. In 2012 only 15 systems used an assumption under 8.0% and no system was below 7.5%. Clearly the trend has steadily moved lower since 2003.

Likewise, nationally we see the same trends. The average assumption in the October 2014 chart was approximately 7.71%; for February 2017, the average was 7.52%. Both the Massachusetts State and Teachers' Retirement Systems' assumptions are 8.0% in the 2014 chart and 7.5% in the 2017 chart.

The cost implications of a reduction in the investment return assumption are significant. Based on our experience, a 25 basis point reduction (for example, a reduction

from 7.75% to 7.50%) in the investment return assumption generally increases the actuarial liability by about 2.5%. Most Massachusetts systems have reduced the investment return assumption 50-75 basis points in the past 7 years, accounting for increases in actuarial liability of 5% to 8%. In turn, this increases the unfunded liability and either increases the amount of annual appropriation or requires an extension in a plan's funding schedule. On the other hand, an assumption that is too low could unduly burden current taxpayers.

It is important to remember that the investment return assumption is a long-term assumption. In recommending an investment return assumption, one important item we review is an analysis of projected long-term rates of investment return. Each year NEPC performs an analysis for PRIT of the expected return on both a short and long term basis.

The most recent analysis was completed earlier this year. The results showed a 30-year average expected annual return of 7.8% per year. This is the same result as outlined in NEPC's analysis completed last year. Note that the 7.8% expected

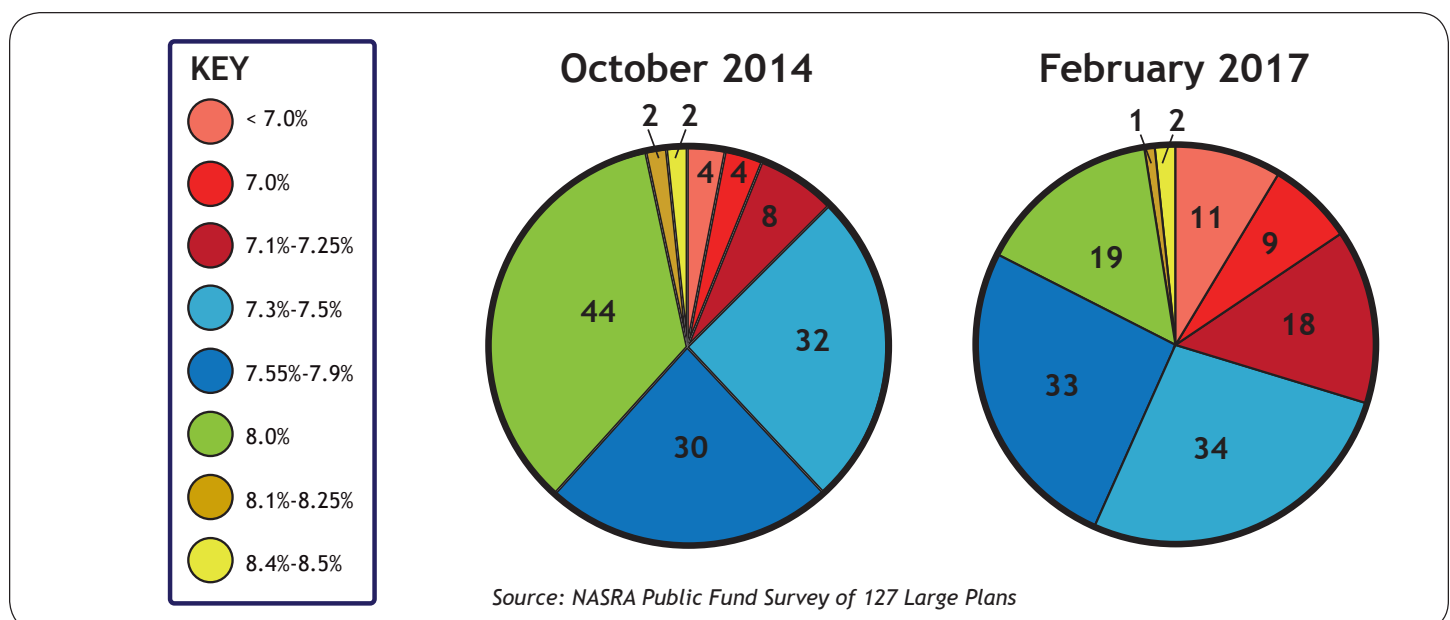
return does not mean that the expected investment return each year will be 7.8%. In fact, over the shorter term (5-7 years) the average expected return is 6.8%. Greater expected returns in later years determine NEPC's 7.8% long-term expectation.

The analysis provides a comparison of expectations for about 70 other public plans with over \$1 billion in assets. These plans forecasted a 30-year expected return of 7.2%, significantly less than that of PRIT. Our understanding is that most of these plans have between one and five billion in assets so they may not provide the best comparison to PRIT with 2016 year-end assets of approximately \$62.5 billion. The difference in expected return reflects allocation differences between PRIT and those other systems. We expect the results would be closer if we were to compare other large state plans with similar asset allocations.

Although actual investment returns are reported on a gross basis, including fees and expenses, investment return assumptions used in Massachusetts public plans are generally net of investment expenses. If PRIT's investment expenses are assumed to be 50 basis points, one could reasonably

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Chart 3



## SELECTING THE INVESTMENT RETURN ASSUMPTION

surmise an investment return assumption on this basis to be 7.3% (7.8% - .5%). However, our understanding of NEPC's analysis is that it is based on indexed or entirely passive investing with negligible fees. Their view is that active management has historically at least offset fees and should continue to do so. On this basis, expected returns are already net of investment expenses.

The Actuarial Standards of Practice (ASOPs) developed by the Actuarial Standards Board provides guidance for selecting an investment return assumption. With respect to investment manager performance, the standard for selecting economic assumptions [ASOP 27] indicates "anticipating superior investment manager performance may be unduly optimistic", thus implying such practice should be avoided. However, the standard also indicates that an "actuary should not assume that superior or inferior returns will be achieved, net of investment expenses from an active investment management strategy compared to a passive investment management strategy unless the actuary believes" that such performance is a reasonable expectation. There certainly is some gray area here, but not being an investment professional, I tend to be conservative and fall more on the side of viewing the projected expected return as a gross figure, not net of investment expenses.

In setting the investment return assumption, there is a range of reasonable assumptions. Other actuaries may have a range that differs from mine. Without considering a plan's asset allocation, the assumption range for Massachusetts public plans is 5.5% to 8.25%. For the national plans, the range is 6.5% to 8.5%. Each retirement board is ultimately responsible for this assumption. Some boards simply adopt more conservative assumption sets.

For the State Retirement System and Teachers' Retirement System, we recently considered whether to maintain the 7.5% investment return assumption (used in the 2016 actuarial valuation) for the 2017 valuation, or reduce it further. A strong case can be made for both positions.

There was no change in the NEPC results from the prior year's analysis. On this basis, maintaining the assumption appears reasonable. The investment return assumption was reduced three times in four years after the January 1, 2012 actuarial valuation, which used an 8.25% assumption. The assumption was reduced to 8.0% as of January 1, 2013, 7.75% as of January 1, 2015 and 7.5% as of January 1, 2016. The 7.5% assumption is comparable to the average assumption of large plans around the country.

The case for reducing the assumption can begin with more reliance on the short-term expectation of 6.8%. Recently two large public retirement systems (California and California State Teachers', known as CALPERS and CALSTRS, respectively) have moved to reduce their current 7.5% assumption to 7.0% over three and two years respectively. If other state systems continue to reduce this assumption, which I believe is likely, 7.5% may be seen as an outlier, whether justified or not. In addition, the current average assumption for the large public plans of slightly over 7.5% would be lower if the assumptions to be used in 2017 actuarial valuations for each system were known and included (for example, CALPERS and CALSTRS are shown in the chart with a 7.5% assumption).

My reasonable range for the investment return assumption for 2017 actuarial valuations is 6.75% to 7.75%. If I narrow this range somewhat to my preferred assumption, my range is 7.25% to 7.5%. I

expect most PRIT systems having a PERAC valuation in 2017 will adopt an assumption in this range. Anecdotally, an informal poll taken of public sector actuaries at the most recent enrolled actuaries' meeting showed the most common investment return assumption ranged between 7.0% and 7.75%.

Actuaries are conservative by nature. But that being said, the reductions in the investment return assumption in recent years (as well as adoption of a generational mortality assumption) do not reflect conservatism as much as our best estimate of long-term expectations. In my view, if we wanted to be extremely conservative, a 6.0% assumption would do the trick.

I reiterate that I am not an investment professional. The purpose of this article is to discuss the analysis surrounding the selection of the investment return assumption, not discuss various investment analysis methodologies that aid in that selection. I rely on investment professionals to perform the simulations and projections that are an important part of the analysis in recommending an assumption. Based on the same data, different actuaries can determine different reasonable ranges for the investment return assumption. Likewise, expected returns can vary significantly among investment professionals. We simply don't know the future. This type of analysis simply provides the most recent best estimate of future expectations based on current economic conditions. Frequent actuarial valuations allow us to continually update our estimates of both plan liabilities and projected assets. ■

# PENSION FORFEITURE COMMISSION NEARS CONCLUSION

Group to Submit Final Report to the Legislature

By Michael DeVito,  
Director of Public Affairs

The Special Commission on Pension Forfeiture, established by Section 151 of Chapter 133 of the Acts of 2016, was created by the legislature in the wake of the Supreme Judicial Court's (SJC) decision in *PERAC v. Bettencourt* (474 Mass. 60, April 6, 2016), which held that a pension forfeiture is a fine for the purposes of the 8th Amendment to the United States Constitution. The SJC is the first state supreme court to conclude that a pension forfeiture is a fine under the 8th Amendment - and to halt a forfeiture as a result. The Commission is tasked with reviewing the *Bettencourt* decision and making recommendations, including amendments to Section 15 of Chapter 32 of the General Laws, and filing a report with the Legislature.



PERAC Associate General Counsel Patrick Charles addresses the Commission

The Special Commission membership includes: the Treasurer or her designee, the Attorney General or her designee, the Senate and House Chairs of the Joint Committee on Public Service, appointees of the Senate President and Speaker of the House, appointees of the Senate and House Minority Leaders, the President of the Massachusetts Association of Contributory Retirement Systems or a designee, one person from the Retired State, County & Municipal Employees Association, and a representative from the Massachusetts District Attorneys' Association. Pursuant to the statute, the Special Commission is chaired by PERAC's Executive Director, Joseph E. Connarton.

PERAC Associate General Counsel, Patrick Charles, conducted research on behalf of the Commission on how other public pension systems handle pension forfeiture.

## From Attorney Charles' research: State Comparison

- Massachusetts is the only state that makes forfeiture possible for a member convicted of a misdemeanor.
- There are six states where public employees do not participate in Social Security: Alaska, Louisiana, Maine, Massachusetts, Nevada, and Ohio – of these six states, their pension forfeiture statutes have varied effective dates and varied criteria.
- Three states provide for a beneficiary

to receive part of a forfeited pension while three do not.

- A number of other states where public employees participate in Social Security provide a partial benefit to an “innocent spouse” or beneficiary. These states include Arizona, Connecticut, Georgia, Michigan, New York, Rhode Island, and West Virginia.
- Georgia utilizes a partial forfeiture by using three times the economic impact as the dollar amount which the member will forfeit.

- West Virginia allows the forfeited member to rejoin the system after he or she has paid the full penalty imposed by law and earn credit again from the new date of membership.

## Criminal offenses that precipitate pension forfeiture vary widely

- Massachusetts applies pension forfeiture when a member is convicted of any crime related to the member's office or position.
- There is no specific provision in Massachusetts that would apply when

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# PENSION FORFEITURE COMMISSION NEARS CONCLUSION

Group to submit final Report to the Legislature



Forfeiture Commission members at work at PERAC

a crime is committed post retirement.

- Massachusetts has forfeited a retired member's pension when he committed crimes while employed in a different position in the public sector.

The Commission heard Mr. Charles provide a review of each subdivision of Section 15, its effective dates and noted which subdivisions appear to be no longer necessary.

### Other points discussed:

- 8th Amendment issue. In *Bettencourt*, the SJC decided that the 8th Amendment applies to pension forfeitures. While Massachusetts is the first

state where the highest court of a state has made this determination, there are some decisions from other states, including in the federal court system, which state that the 8th Amendment does not apply to pension forfeitures.

- State employees losing their benefit over a misdemeanor while paying 9% + 2% for that benefit;
- Paying a partial benefit to "innocent parties";
- Difference between a misdemeanor and felony charges;
- The inability to put a price on the economic impact that involves a victim;

conomic impact that involves a victim;

- That retirement boards are not able to opine on Constitutional issues; and,
- The Massachusetts Teachers' Retirement System has filed legislation (H. 22) that will prohibit teachers from collecting a benefit if they are in possession of child pornography or engage in any sexual act with a minor. ■

**SAVE**  
the DATE

13th  
EMERGING  
ISSUES

FORUM



September 14, 2017

9 am to 3 pm

Look for Registration Materials this Summer!

Attendance = 3 educational credits for Board Members



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