

MAJOR MASSACHUSETTS PENSION REFORM ACT SIGNED LANDMARK ACT APPROVED BY LEGISLATURE AND GOVERNOR IN JUNE

By Michael DeVito
Director of Public Affairs

After several tumultuous months of media attention and stormy debate, the General Court passed a sweeping pension reform bill that was signed into law by Governor Deval Patrick on June 16, 2009. In its press statement about Chapter 21, the General Court wrote:

Senate and House leaders...agreed on landmark pension reform legislation to eliminate loopholes in the current law, saving taxpayer money and restoring public trust in state oversight of public retirement systems. This agreement continues an ambitious reform agenda this year led by Senate President Therese Murray and House Speaker Robert DeLeo. It

includes common-sense modifications to set law that will apply to current and future employees and elected officials in all public retirement systems.

Chapter 21 of the Acts of 2009 eliminates many instances of special treatment and pension perquisites for certain classes of Massachusetts public employees. Among the steps that were taken are the following:

1. Removal of the "one-day, one year" provision that had allowed elected officials to claim an entire year of creditable service for working one day in a calendar year.
2. Removal of the provision that allowed elected officials to claim a "termination allowance" based on the failure to be nominated or re-elected.

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SPECIAL PENSION COMMISSION MEETINGS CONTINUE SUBCOMMITTEES FORMED TO DISCUSS SPECIFIC ISSUES

By Michael DeVito
Director of Public Affairs

The Special Commission on Massachusetts Contributory Retirement Systems, formed by Section 111 of the Chapter 182 of the Acts of 2008 and revised by Section 22 of Chapter 21 of the Acts of 2009, has been meeting since March 31, 2009. The Commission was initially constituted as a 15-member group and charged as follows:

...To make a comprehensive study of the Massachusetts contributory retirement systems. The study shall include but shall not be limited to: contribution rates paid by employers and employees; vesting periods; the weight given to age versus years of

service in the current system; the portability of benefits in the current system; cost-of-living-adjustments with special attention paid to the cost of increasing the cost-of-living-adjustments base and the cost of any recommendations the commission may make.

Chapter 21 added two more members to the Commission and expanded its mission to also include:

....the definition of regular compensation including, but not limited to, whether all forms of compensation taxable under the federal income tax code should constitute regular compensation; current and future employee pension plans and contribution structures; termination allowances pursuant to section 10 of

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NEW TREATING PHYSICIAN STATEMENT REQUIRED THIS FALL FOR DISABILITY APPLICATIONS MEDICAL PANEL REQUESTS AFTER SEPTEMBER 1, 2009 MUST INCLUDE UPDATED FORM

By Frank Valeri
Deputy Director

Many retirement boards are now using the new Treating Physician Statement which is to accompany a Medical Panel Application when it is sent to PERAC. All boards should now be distributing this new form or informing any disability applicant that the new form will be a requirement as of September 1, 2009. This revised form is intended to enhance the member's treating physician's effort to report medical findings and opinions in a more timely fashion and with a certain level of medical clarity. This form is presented in a more user friendly design to bring completion of the form into line with current medical reporting standards and office procedures.

Essentially, the format of the new Treating

Physician Statement differs from the old Physician Statement in two areas. First, it contains fields for specific medical responses and reporting statements associated with each of the three basic questions required for accidental disability eligibility, or in the case of ordinary disability eligibility, the first two questions. Such medical responses and statements may be handwritten in the areas provided or in a narrative using the items listed as a template.

The second major difference in the revised Treating Physician Statement is found in the presentation of the third question. For the purposes of distinguishing between the filing of an Accidental Disability Application and an Accidental Disability under a Presumption there is now a (3A) question for a regular Accidental Disability application and a (3B) question for appli-

cations being filed under the Heart, Lung or Cancer Presumption Laws.

The new Treating Physician Statement form may be found on the 2009 CD which contains all PERAC membership forms. If you do not have a 2009 CD, please contact Sarah Kelly, Director of the PERAC Communication Unit. Ms. Kelly will forward a CD to you. You may also access the information from our website, <http://www.mass.gov/perac>

Medical Panel requests which do not include the new Treating Physician Statement that are received after September 1, 2009, will not be accepted and you will be asked to have the treating physician complete the new Treating Physician Statement. Upon receipt of the new form, the medical panel request will be processed.

DISABILITY TRAINING CLASSES

As a continuation of an on-going educational initiative, staff members from PERAC's Disability, Fraud Prevention, and Actuarial Units will be offering two regional disability training classes in Central and Western Massachusetts. The first session will be held on September 16, 2009, at the Northampton Retirement Board offices (The Council Chambers, 212 Main Street, Northampton, MA 01060). A second class will be held on September 17, 2009 at the Shrewsbury Town Hall (100 Maple Avenue, Shrewsbury, MA 01545). Any retirement board staffer member from the Worcester/Central and Western Massachusetts areas who is interested in attending the training session should contact Regina Manning by calling 617-591-8956. Ms. Manning will send registration forms by mail. If space is available, retirement staffers from other areas may also attend these sessions. Such staff members should also make their interest known to Ms. Manning. Please be reminded that these sessions have been developed for newly hired personnel and staff members who have limited experience with the disability process. PERAC will also offer one additional training session at PERAC before the close of 2009. Details about that session will be furnished at a later date.

PERAC 2009 EMERGING ISSUES FORUM SCHEDULED

On September 9, 2009, the Public Employee Retirement Administration Commission will host the fifth Emerging Issues Forum at the College of the Holy Cross in Worcester, Massachusetts. This year the topic will be public pension reform. Pension reform has been the focus of intense media scrutiny and vigorous debate for many months. Although pension reform is clearly an issue that can no longer be considered "emerging", it is one that affects the entire public pension community and PERAC believes the forum is an opportune setting to assess where things stand and discuss what further changes may lie ahead. Registration forms will be mailed to retirement board members and administrators in the near future.

By Robert Dennis
Investment Director

It seems to happen every ten years or so. After something unusual or unexpected occurs in the financial markets, cries are immediately heard that asset allocation is no longer a useful concept.

During the last few years of the 1990s, asset allocation — the practice of diversifying portfolios among several poorly correlated asset classes — became increasingly out of favor as large cap equities were the best performing asset class year after year. Many respected investment professionals thought that, since we appeared to be in a totally unprecedented and historic period of technological innovation (now known as the dot-com era), the traditional standards for valuing stocks no longer applied. During that time, Wall Street justified lofty stock valuations on the basis of future projected profitability; actual current profitability was hardly relevant at all. Furthermore, there was no need for small caps, value stocks, and certainly not bonds. Needless to say, these concepts were decisively obliterated by the crushing bear market of 2000-2002 and the ensuing recovery which saw value stocks and small caps outperform year after year and when even bonds proved to be a very competitive investment.

While the circumstances are hugely different, asset allocation is once again under attack after the epic market collapse of 2008. This time it was not because one asset class dominated all others over a long period but because, during a financial crisis of epic proportions, all asset classes (except for cash and government bonds) tumbled in unison. The main precept of asset allocation since the ideas were first spawned over 50 years ago was that returns would be smoothed by having investments that didn't move up or down at the same time or at least by the same degree. But in 2008 there proved to be no place to hide.

Up until 2008, diversification had recently worked splendidly for many large public pension plans that had reduced their holdings of traditional stocks or bonds in favor of increased allocation to non-traditional and generally less liquid asset classes like private equity, real estate, international equity, emerging markets, timber, hedge funds, inflation-protected securities and commodities. These other asset classes performed so well for so long in the years prior to last year's collapse that conventional wisdom was increasingly declaring that these portfolios, most typically seen in large endowment portfolios and some large public funds, were the way for smart money to go. Investors who were still concentrated in the more traditional liquid investments were seen as being too conservative. But when the crash hit, none of these alternative asset classes offered any meaningful protection and many endowment funds were scrambling with major liquidity problems to go along with their 20-30% market losses.

As we wrote in the February 2009 issue of the PERAC Pension News ("2008 – What Went Wrong?"), part of what happened in 2008 can be explained by the concept of reversion to the mean. After several years of strong, above-average performance, these other asset classes were at the top of their valuation cycles and were vulnerable to a correction, just as stocks were after one of the longest bull markets in history.

But beyond that, last year's debacle is causing many previous asset allocation proponents to concede that the concepts and models used in most studies do need revaluation and tweaking. First of all, studies had already been showing that correlations between US stocks and other asset classes such as international stocks, real estate investment trusts, and high yield bonds were gradually increasing. Furthermore, academics had not sufficiently recognized or quantified the extent to which correlations during rising stock markets can differ dramatically from those in bear markets. Indeed,

most correlations are significantly greater during down markets. After last year's historic bear market, we saw how it was nearly impossible for any asset class to stay above water. If one asset class appeared to be holding its own against falling equities, strained and panicked investors sought to sell these investments to gain liquidity, thus leading all risky asset classes to plummet last year.

Thus, while not writing off the benefits of diversification, many professionals are at least conceding that the models used until recently were based too much on past relationships that may no longer be valid as a result of changes in the global economy and well as innovations in how people and institutions invest.

As the markets slowly return to normalcy, asset allocation appears ready to emerge from life-support. Those who scorn the endowment model for its disastrous 2008 concede that, over the longer-term (5 years and longer), the records of those favoring nontraditional asset allocation still look good relative to their conservative counterparts. Certainly, no one still thinks, as many did in the late 1990s, that we are in a new era where one style of equities will outperform indefinitely. Still, there remain many challenges to traditional thinking. After all, we can't ignore the surprising fact that as of June 30, 2009, US stocks have underperformed long-term Treasury bonds for the past five, 10, 15, 20, and 25 years. What we have learned is that asset allocation models based solely on past data and not incorporating a wide set of possible outcomes based on changing global economic and financial systems are bound to be imperfect. Yet, asset allocation lives. While recent history has given us historic bull markets as well as epic bear markets, it has still failed to provide any conclusive refutation of the essential adage that investors shouldn't put all their eggs in one basket.

chapter 32 of the General Laws; group classification systems, including the classification of department of correction employees under section 28M of said chapter 32; capping annual pension benefits; penalties for pension fraud; eligibility and level of benefits for employees who participate under 2 or more retirement systems; potential costs, savings or benefits related to moving from a defined benefit retirement system to a defined contribution retirement system for new employees, including a system that maintains eligibility for employees to participate in the Social Security system; qualifications for credit for service pursuant to section 4 of said chapter 32, including minimum compensation limits for officials to be eligible for credit for service....

Professor Alicia Munnell, Director of the Center for Retirement Research at Boston College was appointed Chair of the Commission by Governor Deval Patrick. On July 6, 2009, Chair Munnell appointed three Subcommittees to discuss specific issue areas and return their recommendations to the full Commission:

The Subcommittee on Retirement Security, which reported to the full Commission on July 27, 2009, is considering retiree health insurance, post-retirement survivor benefits, COLA, pension forfeiture, penalties

for fraud, and work after retirement. The Subcommittee's members are:

- Subcommittee Chair Kate Fitzpatrick, Needham Town Manager
- Representative Todd M. Smola
- Representative Robert P. Spellane, Chair, Joint Committee on Public Service
- Ms. Pam Kocher, Director of Local Policy, Massachusetts Executive Office of Administration & Finance
- Professor Alicia Munnell, Director of the Center for Retirement Research at Boston College

The Subcommittee on Benefit Design, which reported to the full Commission on August 3, 2009, is considering classification (groups), averaging period for earnings, accrual rate, anti-spiking, and a pension benefit cap. The Subcommittee's members are:

- Subcommittee Chair Nicola Favorito, Executive Director, State Retirement Board
- Senator Michael Knapik
- Senator Thomas M. McGee, Chair, Joint Committee on Public Service
- Mr. Peter Diamond, Institute Professor, Department of Economics, Massachusetts Institute of Technology
- Mr. Ralph White, President, Retired State, County, and Municipal Employees Association of Massachusetts

The Subcommittee on System Financing, whose report to the full Commission is due August 17, 2009, will consider funding, employer and employee contribution rates, actuarial assumptions, purchase of service, vesting, the interest on accumulations, and portability. The Subcommittee's members are:

- Subcommittee Chair Joseph E. Connarton, Executive Director, PERAC
- Senator Kenneth J. Donnelly, Chair, Joint Committee on Veterans and Federal Affairs
- Representative Michael J. Rodrigues, Vice Chair, Joint Committee on Public Service
- Professor Alicia Munnell, Director of the Center for Retirement Research at Boston College
- Joan Schloss, Executive Director, Massachusetts Teachers' Retirement System

Both the Administration and members of the General Court have pointed to the Special Commission's work as a possible "phase two" of pension reform in 2009. The Special Commission is required to submit its report by September 1, 2009 and it is expected that its legislative recommendations, if any, will be the subject of intense scrutiny, discussion, and debate in the ensuing months.

PERAC AUDIT STAFF TO PARTICIPATE IN MASS COLLECTORS AND TREASURERS ANNUAL SCHOOL

CHIEF AUDITOR HARRY CHADWICK AND JIM TIVNAN TO PRESENT AT UMASS CERTIFICATE PROGRAM

On Wednesday, August 19th, 2009, PERAC Chief Auditor Harry Chadwick and Deputy Auditor Jim Tivnan will be teaching at the Massachusetts Collectors and Treasurers Certification Program, which is being held at the University of Massachusetts, Amherst Campus Center. The 39th Annual School has been a long-standing means of bringing professional training to municipal Collectors and Treasurers.

PERAC Audit staff intends to present the ongoing issues that relate to the conduct of retirement board audits and the boards' relationships with key municipal finance office holders. The auditors will focus on various statutory financial activities, including the care and custody of pension trust funds, payroll certification, and retirement deductions for regular compensation. This review will also include an update on recent pension reform legislation and its effect on Collectors' and Treasurers' duties and responsibilities.

The August event marks the first time PERAC will be participating in the Certification Program.

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3. Changes to the accidental disability retirement benefit provision that are tied to the date of injury and the 12 months of average compensation received prior to such injury are included.

4. Provisions that had allowed certain officials to establish pension credit for serving in uncompensated positions have been eliminated. Also, officers and employees who currently earn \$5,000 or less in compensation will be ineligible for creditable service after their current term expires, or by July 1, 2012, whichever occurs first.

5. Individuals will no longer be permitted to combine the compensation from two positions to artificially increase their "dual service" pensions. Individuals who

are members of two or more systems will receive benefits as if she/her is retiring separately from each system, unless they are vested in both systems before January 1, 2010.

6. The "vesting" requirement of elected officials has been extended from six years to ten years.

7. A loophole that had allowed certain retirees to return to work and receive a full salary in addition to their pension benefits if they were classified as consultants or independent contractors has been eliminated.

8. Other reforms to increase efficiency in the retirement system, such as direct deposit of retirement benefits, were also

included.

PERAC furnished the retirement boards with details about the provisions of Chapter 21 in Memorandum #24 of 2009 (<http://www.mass.gov/perac/09memos/2409.html>).

Further guidance about Chapter 21 will be forthcoming from the Commission. New regulations will also be issued. A new section, Frequently Asked Questions About Chapter 21, has been incorporated into PERAC's website. This helpful information can be accessed at <http://www.mass.gov/perac/index.htm>. The current FAQ's are also printed below.

FAQS REGARDING CHAPTER 21 OF THE ACTS OF 2009

Chapter 21 of the Acts of 2009 extends the limits on post retirement earnings under M.G.L. Chapter 32, Section 91 on members receiving a pension or retirement allowance to those who have retired from an "authority" and it extends the type of earnings that will be examined in assessing violations of those limits to retirees who are employed "...as a consultant or independent contractor or a person whose regular duties require that his time be devoted to the service of the commonwealth, county, city, town, district or authority during regular business hours." What members are subject to these added provisions?

Section 26 of Chapter 21 states that unless otherwise provided the act will apply to "...all members of retirement systems who retire after July 1, 2009". Consequently, this added provision of Chapter 32, Section 91 only applies to earnings by members who retire after July 1, 2009. However, all other provisions of Section 91 would apply to the earnings of those members.

I am 60 years old and have creditable service in two systems prior to 1/1/10. Prior to that date I have 15 years of service in System A and 5 years of service in System B. The service was not concurrent. After 1/1/10 I will have concurrent service of five years making me subject to the Dual Membership provisions of Chapter 21. My average three year regular compensation is \$30,000 in System A and \$10,000 in System B. When I became a member of System A, I transferred to that system my previous non-concurrent service with System B. At retirement how will my non-concurrent service to be treated?

In this example, the member will receive retirement benefits as follows: For the period after 1/10/10, the benefit will not use the combined compensation from System A and System B in the calculation, but the member will receive a separate benefit from each system. To determine the first separate benefit, you would couple the 15 years of service from System A with the 5 years of non-current service in System B, and assuming the member

remains a member for five years after 1/1/10 in System A, a total of 25 years of creditable service would accrue, resulting in the following calculation: $2.0\% \times \$30,000 \times 25 = \$15,000$. The other separate benefit for System B would then be calculated with the member receiving a benefit using the formula 5 (years of concurrent service after 1/1/10), $\times 2.0\%$ (age 60 factor) $\times \$10,000 = \$1,000$ per year. Combining both calculations, the total benefit for the member will be \$16,000 per year (\$15,000 from System A and \$1,000 from System B).

Under the previous formula, the member would have received a benefit based on the combined compensation of the concurrent positions. That would provide a benefit calculated as follows: 25 (years of service) $\times 2.0\% \times \$40,000 = \$20,000$ per year.

A member is employed full-time in a town and also holds an appointed position in a different town. Both units belong to a regional retirement system. She receives a full-time salary of \$40,000 and compensation of \$2,500 in the

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appointed position. Do the membership limits in Section 5 of Chapter 21 impact the "regular compensation" to be used in calculating her retirement benefit?

No, the regular compensation to be used in calculating her benefit will be \$42,500. The \$5,000 earnings requirement in Section 5 addresses the issue of creditable service and does not impact the calculation of regular compensation, however, in order to include that compensation in the retirement calculation the member must continue to make contributions. This also applies to compensation for two positions in the same town. It should be noted that this is not the case if the positions are not in units which are member units of the same retirement system. In addition any compensation to be considered "regular compensation" must meet the definition of "regular compensation".

Chapter 21, Section 5 changes the manner of calculating the pension for a member of two systems in certain circumstances. Who are the members impacted by this change?

There are two classes of members to whom these provisions do not apply - (1) a member who receives regular compensation from two or more governmental units belonging to different retirement systems and is vested in two or more systems as of 1/1/10 and (2) a member who does not receive regular compensation from two or more governmental units belonging to different retirement systems on or after 1/1/10. All other members who receive regular compensation from two or more governmental units belonging to different retirement systems will be impacted by Section 5.

What is the Status of a Call Firefighter and Reserve or Permanent-Intermittent Police Officer?

A call firefighter and reserve or permanent-intermittent police officer making less than \$5,000 as of July 1, 2009 will no longer be an active member of a retirement system. If the retirement board is collecting contributions on such service it

should cease to do so as of July 1, 2009. A call firefighter and reserve or permanent-intermittent police officer will have the same rights as any non-member or inactive member of a Chapter 32 retirement system beginning on July 1, 2009 with the exception of the provisions of G.L. c. 32, § 4(2)(b). A call firefighter and reserve or permanent-intermittent police officer will be able to receive creditable service pursuant to G.L. c. 32, § 4(2)(b) if such person meets the requirements of that section.

Are payments under the "Quinn Bill" regular compensation under Chapter 21?

"The Quinn Bill" established by G.L. c. 42, § 108L clearly provides that Quinn Bill payments become a permanent part of an individual's base pay. Therefore, they are included in the new definition of regular compensation. Funding of the Quinn Bill is a separate issue.

Are other so-called educational incentives regular compensation under Chapter 21?

If educational incentives for individuals are a permanent part of the base salary, such payments are included in the new definition of regular compensation. If not part of the base salary, no, unless provided for in a collective bargaining agreement or employment contract in effect on May 1, 2009, in which case it will remain regular compensation until the contract expires but no later than July 1, 2012.

Are longevity payments, EMT payments, HazMat payments, Defibrillator payments, Homeland Security payments, Stand-By payments, and other similar payments regular compensation under Chapter 21?

If longevity EMT, Hazardous Material, Defibrillator, Homeland Security, Stand-by payments, and other similar payments are permanent part of base pay, such payments are included in the new definition of regular compensation. If not part of the base salary, no, unless provided for in a collective bargaining agreement or employment contract in effect on May 1, 2009, in which case it will remain regular

compensation until the contract expires but no later than July 1, 2012.

Do amounts paid for working holidays for certain public safety personnel continue to be regular compensation?

Yes.

A collective bargaining agreement or employment contract was in effect prior to May 1, 2009. There is no new contract as of July 1, 2009 and the parties are operating under the old agreement until a new one is executed. If a new agreement is executed after July 1, 2009 how will this be assessed under Chapter 21?

If the old contract was in effect prior to May 1, 2009, the successor contract would be effective on the date the old contract expired and payments that were regular compensation will retain that status until the end of the successor contract, but not later than June 30, 2012. Retirement contributions should continue to be withheld while the new contract is being negotiated.

Does the definition of regular compensation impact payments made prior to June 30, 2009?

The new definition of regular compensation established by Chapter 21 does not impact payments made prior to July 1, 2009. Regular compensation status for payments made prior to July 1, 2009 will be determined according to the "old" definition. As a result there will be instances in which a member's three year average will include regular compensation which is determined under both definitions. For example, regular compensation for June 30, 2007 to June 30, 2008 and for July 1, 2008 to June 30, 2009 will be determined under the "old" definition and regular compensation for July 1, 2009 to June 30, 2010 will be determined under the definition established by Chapter 21.