



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report – Issued December 31, 2012

Department of Higher Education's Optional Retirement Program

For the period January 1, 2010 through December 31, 2010



TABLE OF CONTENTS/EXECUTIVE SUMMARY

INTRODUCTION

1

Chapter 15A, Section 40, of the Massachusetts General Laws established the Optional Retirement Program (ORP) administered by the Department of Higher Education (DHE). The ORP is offered to eligible employees of community colleges, state colleges, and universities as an alternative to the State Employees' Retirement System (SERS). The ORP is a defined contribution plan offering both flexibility and portability to plan members.

The objectives of our audit were to (1) determine whether the ORP is being administered efficiently, effectively, and in compliance with applicable laws, rules, and regulations; (2) determine whether DHE has taken appropriate measures to address concerns relative to the operation of the ORP raised in reports issued by an independent actuarial and employee benefits consulting firm in 2006 and 2011; and (3) assess the process DHE used to procure ORP plan providers.

Based on our audit, we determined that DHE needs to make improvements in its administration of the ORP. Specifically, we found that a number of the college administrators whom we surveyed indicated that they had not implemented policies and procedures to ensure that eligibility determinations for ORP participation are conducted in a consistent manner in compliance with all applicable laws, rules, and regulations. We also found that DHE needs to continue to take corrective actions to address issues raised relative to the ORP in the aforementioned 2006 and 2011 consultant reports.

AUDIT RESULTS

5

1. INCONSISTENCIES IN DETERMINING MEMBER ELIGIBILITY AND ENROLLMENT DATA

5

During our audit, we sent a survey to a sample of 15 campus administrators at state colleges/universities, 13 of whom replied. Based on the information we obtained through this survey, we found that campus administrators inconsistently applied the ORP guidance issued by DHE. Specifically, regarding the ORP election period start date, which is the beginning date for the 90-day period in which an employee has the opportunity to elect to participate in the ORP, 10 of the 13 colleges/universities that responded to our survey said they used the individual's date of hire or appointment, two said they used the individual's first day on the job, and another said it used September 1 as the ORP election period start date. Also, one of the 13 campus administrators believed that the minimum workload for participant eligibility for the ORP was 1.0 full time equivalent (FTE) rather than the 0.5 FTE stipulated in the law. We also found that there was no common source used by campus administrators to determine whether applicants met the 0.5 FTE workload requirement for ORP participation. Finally, there was no consistent process used by these administrators to confirm with the State Board of Retirement whether applicants are vested in the SERS, which would make them ineligible to participate in the ORP.

2. PRIOR INDEPENDENT REVIEW ISSUES NEED TO BE ADDRESSED **9**

During 2006 and 2011, DHE contracted with The Segal Company (Segal), an independent actuarial and employee benefits consulting firm, to conduct reviews of the ORP. The 2006 review focused on eligibility, contributions, distributions, retiree benefits, and other operational areas. The 2011 review focused on enrollment, contributions, distributions, and overall compliance. Our review of these reports and discussions with DHE and Segal officials disclosed that certain issues identified in these reports still needed to be addressed. For example, as noted in Audit Result No. 1, we found that there are still inconsistencies among the college campuses in the application of the various plan rules and regulations. Consequently, DHE needs to facilitate a more uniform and comprehensive application of ORP rules and regulations by campus administrators. We believe that DHE should consider conducting periodic reviews of the ORP to ensure that any issues identified are addressed in an effective and timely manner.

OTHER INFORMATION **17**

a. Procurement Process for Selecting ORP Providers **17**

Our audit included an examination of the process used by DHE to select ORP plan providers to provide retirement accounts and services, recordkeeping, and certain other administrative services for participants in the ORP. We found that during our audit period, the process DHE used to select the ORP plan providers was in compliance with applicable laws, rules, and regulations governing such procurements.

b. Comparison of Administrative and Overhead Costs of the ORP with Other Commonwealth Retirement Plans **18**

We found that the annual administration and overhead expenses to total plan assets ratio for the ORP is comparable to other state plans such as the SERS and the Save Money and Retire Tomorrow (SMART) Plan. Specifically, the ORP administrative overhead cost expensed for 2010 was \$1,299,291, or less than 1% of total assets. This expense accounts for .35% of the ORP's total plan assets, which is similar to the SMART Plan (.10%) and the SERS (.17%).

c. Examination and Comparison of Management Fees Paid to ORP Providers **21**

We calculated management fees as a percentage of total plan assets charged to the ORP for 2010 as .73%, or less than 1% of total plan assets. This percentage compares favorably with industry standards but is marginally higher than the corresponding ratios of the SERS (.38%) and the SMART Plan (.16%).

APPENDIX **22**

Colleges and Universities Surveyed **22**

INTRODUCTION

Chapter 15A, Section 40, of the Massachusetts General Laws established the Optional Retirement Program (ORP) administered by the Department of Higher Education (DHE). The ORP is offered to eligible employees of community colleges, state colleges, and universities as an alternative to the State Employees' Retirement System (SERS). The ORP Plan Document, which was adopted in June 2004, provides a thorough description of the plan's features. The ORP is a defined contribution plan offering both flexibility and portability to plan members. DHE acts as the Plan Administrator, responsible for overseeing and ensuring that the ORP complies with applicable laws, rules, and regulations. In accordance with the requirements of the statute, DHE originally chose the Lincoln National Life Insurance Company, TIAA-CREF, and the Variable Life Insurance Company as providers for the ORP. On September 1, 2010, DHE added Fidelity Investments to the list of providers.

Eligibility for participation in the ORP is based on specific criteria. First, an applicant must be classified in one of the following positions: Faculty; Chancellor; Vice Chancellor; President; Vice President; Dean; or Senior Administrator I, II, III, or IV (at the University of Massachusetts only). Second, applicants must work for one of the nine state universities, the 15 community colleges, the University of Massachusetts (five campuses), the Office of the President of the University of Massachusetts, or DHE. Third, applicants must meet the minimum workload requirement of at least a 0.5 full-time equivalent¹, which is the same minimum requirement for eligibility for the SERS. Finally, employees must not be vested in the SERS or any plan governed by Chapter 32, Section 2, of the General Laws, including the Massachusetts Teachers' Retirement System.

According to Chapter 32, eligible employees are required to make a decision within 90 days of their first becoming eligible to participate in the ORP (generally, their date of hire). If an employee does not enroll in the ORP within the 90-day timeframe, he or she will be enrolled in the SERS by default. Individual campus administrators are responsible for identifying newly eligible employees and administering the enrollment process based on the eligibility criteria. Employees are 100% vested from the date they begin participation in the ORP. Benefits provided by the ORP include

¹ Full-time equivalent (FTE) is a unit that indicates the workload of an employed person in a way that makes workloads comparable across various contexts. An FTE of 1.0 means that the person is equivalent to a full-time worker, whereas an FTE of 0.5 indicates that the worker is only half-time.

retirement income (funded both by amounts withheld from employees and by contributions directly from the Commonwealth), long-term disability insurance, and group life insurance.

Employees are required to make contributions into the ORP based on a contribution rate of 9% of their regular compensation, plus 2% of regular compensation in excess of \$30,000 for employees hired on or after July 1, 1996. Employees hired prior to July 1, 1996 are required to make contributions into the ORP based on a contribution rate of 8% of total regular compensation, plus 2% of their regular compensation in excess of \$30,000. In addition, for each eligible employee, the Commonwealth contributes 5% of each employee's regular compensation minus the costs of long-term disability, life insurance, and administrative overhead expenses. The Commonwealth's current net contribution after these deductions is 4.3%. Employer contributions are calculated for each payroll cycle and remitted to the ORP providers. Employee contributions to the ORP are partially tax-deferred for state income tax purposes and fully tax deferred for federal income tax purposes.

The employee's retirement benefit is composed of the total amount contributed and allocated to ORP investment funds and the investment performance of those funds. The employee determines how his or her individual ORP account is invested by choosing a provider and selecting specific investment funds offered by that provider. Benefits are payable any time after terminating employment with the Commonwealth, although employees are entitled to leave their funds in the ORP until they decide to receive benefits. Employees are required to begin drawing a minimum benefit on April 1 of the year following the year in which the employee attains the age of 70½.

As of December 31, 2010, total ORP contributions from employees and from the Commonwealth on the employees' behalf were \$28.8 million and total plan assets were \$372 million. As of December 2010, the ORP had approximately 6,029 individuals invested, with 3,029 active participants making current contributions. Between July and December 2010, 412 employees became eligible to join the ORP, of which 194, or 47%, elected to join.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor conducted an audit of the ORP for the period January 1, 2010 through December 31, 2010.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient,

appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The objectives of our audit were to:

- Determine whether the ORP is being administered efficiently, effectively, and in compliance with applicable laws, rules, and regulations.
- Review DHE's oversight and monitoring of the ORP.
- Review ORP administrative and overhead costs.
- Review management fees paid to the ORP providers to determine their reasonableness.
- Compare ORP costs and management fees to those of the Commonwealth's Deferred Compensation Program and SERS.
- Review the most current process used to select ORP providers.
- Reviewed independent consultant reports prepared in 2006 and 2011 by The Segal Company (Segal) regarding the administrative operations and practices of the ORP and determine whether the reported issues have been addressed.

To accomplish our objectives, we:

- Interviewed officials and staff at the ORP and the various campuses and reviewed ORP laws, rules, regulations, policies, and procedures to gain an understanding of the ORP's administrative system and internal controls.
- Interviewed Segal representatives regarding their reports.
- Reviewed the ORP's management fees and administrative expenses to determine whether they were reasonable and comparable with those of other Massachusetts state employee retirement plans.
- Sent a survey to 15 campus administrators regarding compliance with enrollment, eligibility, minimum workload requirements, vesting status in the SERS plan, and payroll and other administrative procedures. This number represents more than 50% of the locations offering the ORP to employees, and we consider this to be a non-statistical, random selection.
- Reviewed and analyzed the information from the 13 of 15 campus administrators who responded to the survey.

We assessed the reliability of ORP data by (1) reviewing existing information about the data and the system that produced them and (2) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

AUDIT RESULTS

1. INCONSISTENCIES IN DETERMINING MEMBER ELIGIBILITY AND ENROLLMENT DATA

Our audit found that some campus administrators inconsistently applied the Optional Retirement Program (ORP) guidance issued by the Department of Higher Education (DHE) to ensure compliance with Chapter 15A, Section 40, of the Massachusetts General Laws. Specifically, regarding the ORP election period start date, which is the beginning date for the 90-day period in which an employee has the opportunity to elect to participate in the ORP, 10 of the 13 colleges that responded to a survey administered by the Office of the State Auditor said they used the individual's date of hire or appointment, two said they used the individual's first day on the job, and another said it used September 1 as the ORP election period start date. Also, one of the 13 campus administrators believed that the minimum workload for participant eligibility for the ORP was 1.0 full-time equivalent (FTE) rather than the 0.5 FTE stipulated in the law. We also found that there was no common source used by campus administrators to determine whether applicants met the 0.5 FTE workload requirement for ORP participation. Finally, the process of confirming with the State Board of Retirement (SBR) as to whether new applicants to the ORP are vested in the State Employees' Retirement System (SERS), which would make them ineligible for the ORP, was not uniform among college campus administrators. As a result of these issues, there is a higher-than-acceptable risk that errors might occur in determining an employees' eligibility to participate in the ORP.

Chapter 15A, Section 40 (2)(a), of the General Laws describes the provisions for eligibility in the ORP as follows:

Participation in the optional retirement program provided by this section shall be limited to persons who are otherwise eligible for membership in the state employees' retirement system as established under the provisions of chapter 32; provided, however, that they are faculty members, chancellors, vice chancellors, presidents, vice presidents, deans, or holding a position classified as a senior administrator IV, senior administrator III, senior administrator II, senior administrator I of the board of higher education or public institutions of higher education, as defined in section 5.

In addition, this statute states that an employee is eligible to participate in the ORP under the following circumstances:

(i) Any eligible employee who is initially appointed on or after the effective date of the optional retirement program may elect in writing to participate in the optional retirement

program within ninety days² of the effective date of the appointment. Any such election shall be effective as of the effective date of appointment. If an eligible employee fails to make an election as provided in this paragraph, such employee shall become a member of the state employees' retirement system established under the provisions of said chapter thirty-two.

(ii) Any eligible employee who is a member of any retirement system established under the provisions of said chapter thirty-two on the effective date of the optional retirement program but who has less than ten years of creditable service on the effective date of the optional retirement program may elect in writing to participate in the optional retirement program within ninety days after the effective date of the optional retirement program. Any such election shall become effective on the first day of the pay period next following such election, and shall constitute a waiver of all retirement benefits to which the individual may be entitled as an employee under any retirement system established under the provisions of said chapter thirty-two.

(iii) Any employee who is a member of any retirement system established under the provisions of said chapter thirty-two but who has less than ten years of creditable service on the date such employee becomes eligible to participate in the optional retirement program may elect in writing to participate in such optional retirement program within ninety days of the date said employee becomes eligible. Any such election shall become effective on the first day of the pay period next following such election, and shall constitute a waiver of all retirement benefits to which the individual may be entitled as an employee under any retirement system established under the provisions of said chapter thirty-two.

The Board of Higher Education (the Board) is identified in the statute as the ORP Plan Administrator. As such, the Board has adopted policies and procedures that further define the terms in the statute. The Board amended the ORP in relevant part effective July 1, 2007 (FAAP 07-31) to define the Election Period as follows:

Election Period is the period during which newly eligible employees may choose to participate in the Plan. The Election Period is comprised of ninety (90) calendar days, beginning with the first day that the Eligible Employee is actively at work, performing their duties for compensation by the Employer.

During our audit, we sent a survey to a sample of 15 campus administrators at state colleges and universities, of whom 13 replied. Regarding the ORP election period start date, 10 of the 13 colleges that responded to our survey said they used the individual's date of hire or appointment, Northern Essex Community College and Worcester State University said they used the individual's first day on the job, and Westfield State University said it used September 1 as the ORP election period start date. In addition, the campus administrator of Bristol Community College who responded to our survey believed that the minimum workload for participant

² It should be noted that subsequent to the audit period, the statute has been amended to increase the election period from 90 days to 180 days.

eligibility for ORP was 1.0 FTE rather than the 0.5 FTE mandated by Chapter 32, Section 2, of the General Laws. Moreover, we found that there was no common source used by campus administrators to determine whether applicants met the 0.5 FTE workload requirement for ORP participation. For example, the responding administrators indicated that they used job categories, job descriptions, collective bargaining agreements for faculty and non-faculty positions, and college Personnel Policies and Procedures Manuals in determining the amount of full-time work for the ORP candidate. They also indicated that they relied on information from other sources, including hire letters, human resources department information, and payroll department information through the Commonwealth's Human Resources/Compensation Management System (HR/CMS)³, for the verification of job titles and minimum workload calculations.

The results of our survey also revealed that the process of confirming with the SBR whether applicants to the ORP are vested in the SERS is not uniform among the college campus administrators that participate in the ORP. Five (Holyoke Community College, Westfield State University, Northern Essex Community College, Bristol Community College, and Mount Wachusett Community College) of the 13 respondents indicated that they contact the SBR to determine whether an individual participates in the SERS. The other eight campus administrators indicated they asked the participants whether they were members of the SERS, checked whether participants had indicated on an application for employment that they were members of the SERS, or queried human resource departments to validate personnel data (e.g., resumes) to confirm their participation in the SERS.

Recommendation

In order to address our concerns relative to this matter, DHE should develop and implement policies and procedures for campus administrators to follow that will establish uniformity in the process used to determine ORP eligibility. These policies and procedures should address, among other things, how to verify applicant information, including contacting the SBR to verify an applicant's status in the SERS, the proper date to use in establishing each applicant's ORP participation election period, and acceptable sources of information that should be used to establish the FTE status of applicants. These policies and procedures should be available online to all administrators, and administrators should be trained in this area.

³ HR/CMS is the payroll system through which all non-UMass state employees are paid.

Auditee's Response

The DHE's rule to determine the Election Period start date is the first day that an eligible employee is actively at work in the eligible position. This is not necessarily the employee's Date of Hire; an employee could become eligible for ORP participation long after their hire date. Our interpretation of the enabling legislation's Election Period start date reflects many years' experience with the vagaries of employment in higher education and we have begun investigating a new approach where the Election Period would start with the first pay period in which an employee is eligible for ORP participation.

DHE indicated that its objective in the current approach to the Election Period is to:

Provide an Election Period that is truly useful to the newly eligible employee, allowing them the greatest period possible to study the two retirement plans before choosing one; that the Election Period starts at a point where the employee is reasonably available to meet with campus administrators; attend orientations and learn about plans.

Allow some reasonable latitude in local administration of this aspect of the Plan; as noted above, the processes of determining who is eligible for ORP coverage; providing notice of eligibility; and enrolling eligible employees can vary by campus – with these differences typically driven by size of the institution.

This is a core subject in our training "Workshops" for administrators every year.

While current approach has been in effect since 2006, we still find too many circumstances that cannot meet the "actively at work" definition. Accordingly, we have begun investigating a new approach where the Election Period would start with the first pay period in which an employee is eligible for ORP participation. We have already begun discussing a focus group of campus administrators to help vet this process.

After years of experience with the ORP, campus administrators take best advantage of the sources of information available to them, determining each person's minimum workload is especially challenging. This is attributable, in part, to the amount and quality of data input by employing departments; and in part by the way the Information Warehouse stores the information...or not. The DHE is currently working to develop queries that draw warehouse data for us in calculating workloads as a percentage of Full Time Equivalent (FTE's).

There is simply no source of vesting information for the many other retirement plans operating under Chapter 32. The Commonwealth's approach to this aspect of ORP eligibility has been to accept each employee's written representation that they are not vested in any Chapter 32 plan. Absent calling the Retirement board to check the status of every eligible employee, no source of vesting information in the Massachusetts State Employees Retirement System (MSERS) currently exists.

Auditor's Reply

Although Chapter 15A and DHE regulations and rules establish an ORP election period start date, our audit found inconsistencies in the start dates campus administrators use at the state colleges and universities we surveyed. Consequently, we again recommend that DHE clearly

define the start date for the ORP election period and provide uniform guidance, such as policies and procedures, that is practical and effective for campus administrators to follow when screening eligible applicants for the ORP.

Further, we again recommend that a reliable source of employee FTE information, usable at all locations, be adopted and uniformly applied among all of the locations offering the ORP. Finally, all employees applying as ORP candidates should have their retirement status checked with the SBR. Given the small number of new applicants each year (on average six to 10 per location), it is not an unreasonable task for campus administrators to perform.

2. PRIOR INDEPENDENT REVIEW ISSUES NEED TO BE ADDRESSED

In 2006 and again in 2011, DHE contracted with The Segal Company (Segal), an independent actuarial and employee benefits consulting firm, to conduct a review of the ORP. The 2006 review focused on eligibility, contributions, distributions, retiree benefits, and other operational areas. The 2011 review focused on enrollment, contributions, distributions, and overall compliance. During our audit, we asked DHE officials about the status of the issues that Segal reported in its 2006 and 2011 reports regarding (a) eligibility and enrollment, (b) contributions, (c) distributions, and (d) retiree benefits. A summary of each issue—and the measures DHE stated it has taken to address these issues—follows.

a. Eligibility and Enrollment

There were several issues raised as a result of the 2006 review in the areas of eligibility and enrollment, including inconsistent use of hiring dates, calculation of the election period, effective date of enrollment, and minimum workload requirements for participation and verification of prior service.

First, this review identified inconsistencies among campuses in the determination of the actual enrollment date of a new participant. Some campuses used the current pay period, whereas the correct approach is to enroll in the pay period following the receipt of all completed enrollment forms. The report also noted that workshops for campus administrators focused on the effective date of enrollment, which emphasized that enrollment in the plan occurs with the pay period that begins after receipt of all completed enrollment documents.

Second, this review disclosed that the workload requirement of Chapter 32, Section 2, of the General Laws was inconsistently applied by campuses as an eligibility criterion. Further, this review found that many of the schools confirmed the prospective employees' participation in the SERS only if the employees indicated that such prior service existed, and that the process of checking that status was not independently performed by the colleges.

DHE has indicated that the eligibility and enrollment issues disclosed in this 2006 review were addressed by restating the Plan Document on July 1, 2010 and by training. DHE officials further stated that they reviewed the participants' Notices of Eligibility that specify the beginning and ending dates of the 90-day election period allowed for participants to join the ORP. DHE officials also indicated that they were working toward online enrollment for all new employees.

Although DHE indicated that the above issues were identified and addressed by amending the Plan Document and through training, as noted in Audit Result No. 1, our survey of campus administrators indicated that there is still inconsistent application of the guidelines and determination of employee eligibility regarding effective date of appointment, enrollment period, and the FTE requirement.

b. Contributions

The 2006 review raised several issues in the area of contributions, including definition of regular compensation, employee plan contributions under the Uniform Services Employment and Re-Employment Rights Act, definition of compensation (under the Internal Revenue Code), plan contribution limits, and Social Security reporting. The 2011 report addressed only three issues--plan contributions, definition of compensation limits, and plan contribution limits--because the other three issues were resolved. The three unresolved issues, as discussed in the 2006 and 2011 reports, and any actions taken by DHE to address these issues, follow.

The 2006 review identified inconsistencies in the rate of employee plan contributions for eligible former employees who returned to work for the Commonwealth. As former employees, they had contributed at a lower rate than the current rate when reemployed. The "old" contribution rate, prior to July 1, 1996, was based on a contribution rate of 8% of total regular compensation, plus 2% of regular compensation in excess of \$30,000. The "new" contribution rate, effective after July 1, 1996, is based on a contribution rate of 9% of total regular compensation, plus 2%

of regular compensation in excess of \$30,000. Some reemployed participants were entered at the “old” rate and some at the “new” rate. As a result of this finding, the Plan Document was amended by DHE to clearly indicate that the rate of employee contribution for participants who are reemployed shall be equal to the percentages of compensation applicable to employees hired at the time of re-employment. DHE also developed a comprehensive online Administrators’ Guide, which specifically addresses the definition of employee termination and has been beneficial in determining when a reemployed former participant is entitled to a new election period. DHE officials told us that this issue is also regularly addressed at campus administrator workshop training sessions.

The 2011 review found no discrepancies in calculating the correct rates for the 4.3% Commonwealth contributions, but did find problems with calculations relative to the prorated application of the 2% over the \$30,000 annual salary, on a biweekly basis, for employees who began employment midyear. Although the discrepancies appear to be minor (under \$100 annually per individual), the 2011 review recommended correcting contributions made to the ORP in 2010 so that they do not violate Internal Revenue Code (IRC) regulations.

The 2006 review highlighted the absence of an automated control to monitor the maximum amount of compensation that may be used to determine benefits (“contributions” in the case of the ORP) under IRC Section 401(a)(17) for participants whose compensation is administered by HR/CMS. These participants were employed by the state and community colleges and the Board of Higher Education (now DHE). The University of Massachusetts payroll system includes such a control. The 2011 review highlighted the same issue of the absence of an automated control to monitor the maximum amount of ORP contributions for individual participants whose compensation is administered by HR/CMS. Further, this review noted that measures taken by DHE to address this issue should be monitored because discrepancies exist with employer and employee contributions to the ORP and the limits imposed by IRC Section 401(a)(17) that restrict total employee compensation to \$245,000 in calculating contribution amounts.

DHE’s internal recordkeeping database has been upgraded to automatically monitor the maximum amount of compensation that may be used to determine benefits under IRC Section 401(a)(17) (\$245,000 in 2010) for participant compensation administered by HR/CMS. In addition, HR/CMS is being updated to monitor these limits for purposes of employee plan

contributions. DHE also indicated that the University of Massachusetts payroll system automatically monitors the limits on salary.

c. Distributions

There were several issues raised as a result of the 2006 review relative to distributions to participants: DHE participant files, beneficiary distributions, joint and survivor annuity references, spousal consent for distributions, required minimum distributions, lump-sum distributions, and domestic relations orders. A discussion of each of these 2006 issues, the status of these issues as of the 2011 review, and any actions taken by DHE follow.

The 2006 review identified several cases where paperwork relating to individual distributions from the ORP was not filed in participants' folders. The 2011 review found an employee's signature on only one of two elections for distributions, and the employee's signature was dated two months after the distribution application was approved by DHE. The 2011 report also identified cases in which the Commonwealth had not distributed assets to beneficiaries under the ORP when the participant had died. The IRC requires that assets be distributed within a year after the death occurs. DHE officials stated that the agency has revised its administrative practices to assign responsibility for mailing distribution forms and maintaining copies in participant files to a single staff member. Also, DHE conducts random audits of benefit payments made by providers and increasingly relies on electronic versions of forms to reduce incidences of misplaced hard-copy forms. Further, DHE indicated that it has developed a system-based control to monitor all death benefit payments made by providers. DHE has also instituted a requirement that the provider must receive authorization from the plan administrator prior to disbursing death benefit payments.

The 2006 group discussion that Segal conducted with campus administrators identified confusion regarding references to annuities as the normal form of payment under the plan. DHE officials told us that DHE subsequently conducted a training workshop for administrators on this issue, emphasizing that all benefit payment methods are available to plan participants who have terminated employment, as indicated in the plan summary. However, these officials said that during the training DHE explained that the "normal form" of benefit payment is an annuity, which aligns with the Commonwealth's other pension plans and alleviates the participants' exhaustion of income over their lifetime.

The 2006 review indicated that plan administrators were confused about the need for spousal consent for distributions from the plan. Private employers who are subject to the Employee Retirement Income Security Act of 1974 (ERISA) must comply with the provisions of the Retirement Equity Act of 1984, which requires spousal consent to any plan distribution that does not provide at least one-half of the benefit continuing to the spouse. Although the Commonwealth is not required to and does not comply with ERISA and the Retirement Equity Act, the providers often, mistakenly, request spousal consent from ORP participants. DHE officials told us that agency officials met with providers on January 22, 2007 to address this issue, and instructed the providers to distribute “non-ERISA” forms and applications to plan participants. DHE proposed the use of standardized distribution forms that are unique to the ORP as a result of the 2011 Segal review, obviating the use of ERISA forms by the providers. All ORP providers agreed to use the proposed form and help in its development. DHE officials stated that there are instances in which plan participants request notarization for a spousal consent. The 2011 review did not address this issue, but suggested periodic DHE audits of vendor operations and individual files because the plan administrators have no role in many distribution functions. DHE indicated at the time of our audit that it is preparing a brief booklet with an overview of drawing funds from the ORP that it was going to distribute that would provide cursory information about ORP distributions and instructions on how to access detailed information on the ORP’s websites.

The 2006 review identified several cases in which required minimum distributions for participants who had terminated employment and attained age 70½ had not been paid on a timely basis. DHE conducted an internal audit in 2007, which revealed that all such participants had received the required minimum distributions in a timely manner. In addition, DHE has a control in place that requires the four ORP providers to annually report to DHE all participants who attain the age of 69 and hold assets in the ORP. DHE told us that this reporting from the ORP providers, DHE’s system-based control files, and an annual DHE internal audit to confirm that required minimum distributions are paid prior to the end of each year collectively ensure compliance with this requirement.

The 2006 review indicated that there was confusion about the lump-sum feature of the ORP that provides different treatments of “old” funds (assets attributable to contributions made prior to July 1, 2004) and “new” funds (assets attributable to contributions made after June 30, 2004).

For participants younger than age 55 at the time of distribution, a lump-sum payment shall be permitted only if the participant elects an eligible rollover distribution to another qualified retirement plan or individual retirement annuity. Effective July 1, 2004, the lump-sum payment option was not permitted to participants younger than age 55 for employer and employee contributions and earnings attributable on and after July 1, 2004. In addition, the review expressed concern that participants were using the de minimis⁴ benefit provision (which allows the lump-sum distribution of account balances less than \$5,000) to circumvent the plan's lump-sum provision. Employees may have taken the maximum lump sum of their "old" funds, leaving a de minimis balance of "new" money that could then be paid as a lump sum. DHE provided training for campus administrators and providers on lump-sum distributions in 2007. DHE officials told us that the agency has improved descriptions of this feature in all printed materials and through training. The officials also stated that de minimis distributions are negligible—approximately one or two per year—and that the use of a de minimis lump sum has effectively disappeared, but the 2011 report indicated that there was still confusion among plan participants and campus administrators over the rights of employees under 55 to access their money.

The 2006 report highlighted the need for the Commonwealth to develop a policy and administrative guide for the administration of Domestic Relations Orders (DROs). These DROs are typically issued to provide the distribution of marital assets, including retirement plan assets, upon a participant's divorce. DHE hired Segal as a consultant to develop procedures and controls to administer the implemented DROs. DHE also has a sample DRO that participants may use as a model for their legal counsel in preparing their own DROs. Further, DHE monitors ORP plan providers to ensure that "alternate payees" designated as recipients under DROs are correctly compensated. The 2011 review did not address this issue.

d. Retiree Benefits

There were three issues raised as a result of the 2006 review, which analyzed retiree benefits from the Group Insurance Commission (GIC), total years of creditable service, and the minimum retiree income requirement for GIC benefits. These issues that were not mentioned in the 2011 review are discussed below.

⁴ De minimis refers to items so small or minimal in difference that they do not matter or the law does not take them into consideration.

In its 2006 review, Segal suggested that the Commonwealth develop and implement an authorization form that all retirees should use to document their intent to have their retiree insurance premiums deducted from their monthly retiree income for their GIC benefits. DHE indicated that the ORP's enabling legislation was amended to clarify that retirees are deemed to have authorized their providers to deduct retiree insurance premiums from the participants' monthly income.

The 2006 review identified confusion among campus administrators relating to the accumulation of years of creditable service for purposes of meeting the service requirement for post-employment benefits from the GIC. The GIC recognizes years of participation in the ORP plus any years of creditable service under the State Employees' Retirement System (SERS) for ORP participants in meeting the service requirements for post-employment benefits. Eligibility for post-employment is a key issue that is continually presented at campus administrator workshops. DHE stated that it has the sole responsibility of determining ORP participants' eligibility for retiree insurance from the GIC and has developed a section on its website allowing campus administrators to access DHE's calculation of ORP participants' total years of creditable service to expand resources for serving participants.

The 2006 review highlighted confusion among participants about the Commonwealth's requirements for the monthly minimum income that must be available in order for GIC benefits to be drawn and for the employee to be eligible for retiree insurance benefits from the GIC. DHE officials told us that DHE has conducted workshops for campus administrators on this issue and has provided training to providers to clarify their role in the process. Participants are able to access additional information on the ORP participant website, and a retiree checklist was developed to aid participants in the process.

Recommendation

DHE should continue its efforts to address the inconsistencies among the campuses in the application of the various plan rules and regulations by the campus administrators. DHE should also continue to foster a more uniform and comprehensive application of these rules and regulations by the campus administrators. Finally, DHE should conduct interim reviews between audits at randomly selected campuses to determine that issues discussed at its administrative workshops are properly addressed. The effort to emphasize consistent application of ORP rules

and regulations among the campuses, along with the introduction of the new online enrollment system, will be the best way for DHE to address the issues revealed by prior audits.

Auditee's Response

The DHE will proceed with this recommendation and intends to implement our first reviews [relative to campus audits] in early 2012.

OTHER INFORMATION

The following is provided for informational purposes regarding (a) the Optional Retirement Program (ORP) procurement process; (b) a comparison of the ORP, Deferred Compensation Save Money and Retire Tomorrow (SMART) Plan, and the State Employees' Retirement System (SERS); and (c) a comparison of management fees paid to providers.

a. Procurement Process for Selecting ORP Providers

We reviewed the most recent selection process used by the Department of Higher Education (DHE) during our audit period for firms to provide ORP retirement services. DHE solicited qualified firms to provide retirement accounts and services, recordkeeping, and certain other administrative services for participants in the ORP. The ORP's enabling legislation requires no fewer than two and no more than four providers. The current providers at the time of this procurement--Lincoln National Life Insurance Company, TIAA-CREF, and the Variable Life Insurance Company (VALIC)--were required to submit proposals to this new solicitation in order to be considered to retain their position as providers. The Requests for Proposals (RFPs) were processed through the Commonwealth's Procurement Access and Solicitation System (Comm-PASS).

All bidders were required to be registered and licensed to conduct business in the Commonwealth of Massachusetts and meet various statutory requirements. The selection procedure and evaluation criteria for the qualified firms, as outlined in the RFP, states the selection would be made and evaluated as follows:

All proposals will be reviewed by the Evaluation Team based on information contained in the Firm's proposal. Proposals will be read and ranked by the Evaluation Team based upon the applicability of the Firm's experience, ability to meet the minimum requirements, the suitability of their product and services, and cost for their product, as evidenced by the response provided by the Firm to the RFP. The Evaluation Team may choose to invite selected vendors to make oral presentations. Qualitative assessments of firms may be made during oral presentations.

Although cost is a factor in the award decision, final selection will not necessarily be made to the firm offering their product and services for the lowest cost.

Accordingly, proposals were reviewed by an evaluation team and ranked based on the applicability of the firm's experience, its ability to meet minimum requirements, the suitability of its products and services, and the cost of the product. Costs were to be considered as only a single criterion. DHE evaluated prospective providers of financial management services for the ORP participants' funds

based on numerical scoring evaluation criteria that were applied to seven distinct areas of review: company experience and general information, administrative requirements, services plan sponsor, services participants, product information, general administration, and company personnel. Each of these seven areas had selected performance-related scoring areas with questions for numerical rating to arrive at an overall scored rating for the provider. There were a total of 62 of these scoring area questions in the seven areas of review. The providers were reviewed and evaluated, with the higher-scoring providers considered for selection.

The preponderant areas of interest outlined in the RFP related to the historical performance of the prospective funds that were vying to become ORP investment service providers. These areas of interest included manager competency with similar funds; provider's history of handling amounts and types of assets under management that are similar to the ORP's amounts and types of assets under management; and the fund's capabilities in collection, distribution, and flexibility in handling account rollovers and payments to participants upon retirement.

Of the eight providers who submitted proposals, DHE selected Fidelity Investments in addition to the continued services provided by Lincoln Financial Group, TIAA-CREF, and VALIC. The contracts for these services, which began on September 1, 2010, will continue for seven years, subject to annual review by DHE.

Our examination of the process used to select ORP providers revealed that this process was in compliance with applicable laws, rules, and regulations governing such selections.

b. Comparison of Administrative and Overhead Costs of the ORP with Other Commonwealth Retirement Plans

As part of our audit, we compared the ORP's administrative and overhead costs and management fees paid to ORP providers to those fees paid by the Commonwealth of Massachusetts Deferred Compensation SMART Plan and the SERS.

Description of the Plans

The Commonwealth of Massachusetts Deferred Compensation SMART Plan offers a deferred compensation investment plan to its eligible employees. The plan is open to all employees of the Commonwealth of Massachusetts and participating governmental entities. There are no age or

service requirements to enroll or participate in the SMART Plan, and employees are vested immediately. The plan is an Internal Revenue Code (IRC) Section 457 deferred compensation retirement plan that allows eligible employees to make contributions to an account established on their behalf. Contributions are made on a pretax basis, and all earnings are tax-deferred. The amounts accumulate on behalf of the employee and may be distributed at retirement as benefits or due to another qualifying event, such as separation from service or death. The SMART Plan is an alternative to Social Security as permitted by the Omnibus Budget Reconciliation Act (OBRA) of 1990. OBRA, passed by Congress, requires that employees not eligible to participate in their employer's retirement programs be placed in Social Security or another program meeting federal requirements. The SMART Plan meets those requirements. There were 175,232 OBRA participants in the SMART Plan as of December 31, 2009. All other non-OBRA participants can invest in the full range of SMART Plan offerings.

The SERS is a defined benefit retirement plan⁵ administered by the State Board of Retirement, which provides predictable and guaranteed retirement income. Chapter 32 of the Massachusetts General Laws defines the system, eligibility requirements, and benefits. Membership in the system is mandatory for nearly all state employees regularly employed on a half-time or full-time equivalent basis. All members make mandatory contributions on a pretax basis through payroll deductions. The plan is governed by IRC Section 401(a). Contributions are based on 9% of the total regular participant's compensation, plus 2% of compensation in excess of \$30,000 for employees hired after July 1, 1996 and 8% of total regular participant's compensation, plus 2% in excess of \$30,000 for employees hired prior to July 1, 1996. Administrative overhead costs are the costs of registering the funds and complying with securities laws, including creating and distributing the prospectus and shareholder reports, and trading costs.

The legislation enacted to create the ORP included Commonwealth payments in the amount of 5%, matching the employee contribution. Included in this is .335% deducted for the ORP's administrative overhead. The .335% from the amount of Commonwealth contributions over this administrative overhead expense amount (unexpended) is allocated to the providers in proportion to the participants' investment selections.

⁵ A defined benefit pension plan is a type of pension plan in which an employer promises a specified monthly benefit on retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than depending on investment returns.

The annual administration and overhead expense to total plan asset ratio for the ORP is comparable to other Commonwealth retirement plans such as the SERS and the SMART Plan. The ORP administrative overhead cost expensed for 2010 was \$1,299,291. This expense accounts for .35% of the ORP's total plan assets, which is similar to the SMART Plan (.10%) and the SERS (.17%).

Administrative and Management Fee Comparative Analysis

	ORP ⁽¹⁾ 12/31/2010	SERS ⁽²⁾ 6/30/2010	SMART Plan ⁽³⁾ 12/31/2009
Employee Contributions	\$18,900,000	\$451,025,045	\$302,758,000
Employer Contributions	<u>9,900,000</u>	<u>455,369,723</u>	<u>0</u>
Total Contributions	<u>\$28,800,000</u>	<u>\$906,394,768</u>	<u>\$302,758,000</u>
Total Plan Assets	\$372,000,000	\$19,093,494,586	\$4,545,062,000
Administration and Overhead	\$1,299,291	\$31,871,427	\$4,545,062
Management Fees to Providers	\$2,713,548	\$73,555,215	\$7,215,217
Management Fee % Total Assets	.73%	.38%	.16%
Management Fee % Contributions	9.4%	8.11%	2.38%
Administration and Overhead % Total Assets	.35%	.17%	.1%
Administration and Overhead % Contributions	4.51%	3.52%	1.5%
SERS Active Membership	0	86,309	0

SERS Beneficiary Members	0	54,047	0
Full-Time Participants	3,029	0	93,027
Part-Time Participants	0	0	178,203
Inactive Participants	<u>3,000</u>	<u>37,913</u>	<u>0</u>
Total Participants	<u>6,029</u>	<u>178,269</u>	<u>271,230</u>

(1) Source Data from 2010 RFP for new provider.

(2) Source Data from 2010 State Retirement Board Annual Financial Statement.

(3) Source Data from KPMG independent audit of the Commonwealth of Massachusetts Employees Deferred Compensation Plan, December 31, 2009.

c. Examination and Comparison of Management Fees Paid to ORP Providers

According to industry standards, management fees as a ratio of plan assets typically run between .5% and 1%. Management fees are paid to providers based on the amount of assets under management in a fund. The four investment management service providers selected by the ORP charged a total of \$2,713,548 in management fees for their investment services in the following amounts for calendar year 2010:

ORP Management Fees Calendar Year 2010

TIAA-CREF	\$1,531,427
VALIC	907,950
Lincoln Financial	256,592
Fidelity	<u>17,579</u>
Total	<u>\$2,713,548</u>

We calculated management fees as a percentage of total plan assets charged to the ORP for 2010 as .73%, or less than 1% of total assets. This percentage compares favorably with industry standards but is higher than the SERS at .38% and the SMART Plan at .16%.

APPENDIX**Colleges and Universities Surveyed**

Bridgewater State University
Bristol Community College
Cape Cod Community College
Framingham State University
Holyoke Community College
Massachusetts Maritime Academy
Massasoit Community College
Mount Wachusett Community College
Northern Essex Community College
Roxbury Community College
University of Massachusetts Boston
University of Massachusetts Lowell
University of Massachusetts President's Office
Westfield State University
Worcester State University