



LETTER FROM THE EXECUTIVE DIRECTOR



The Commission and staff are pleased to release this Annual Report on the Massachusetts Public Retirement Systems for 2015, a year in which despite flat capital markets progress was made in adjusting to governance reforms, increasing transparency and updating actuarial assumptions. In the latter area retirement boards have adopted more conservative investment assumptions, updated mortality tables and addressed new accounting standards and, as a result, stand well positioned for meeting the fiscal challenges ahead.

As we went to press with the 2014 Annual Report the threat of weakened statutory provisions related to board governance, transparency and best practices was embodied in outside sections contained in the FY 2015 Budget adopted by the Legislature. It was my belief at the time and it remains my belief that these proposed changes were animated by the fact that undue influence on board decisions has been reduced by Chapter 176.

One of those recommendations which would have effectively eliminated the need for due diligence in the majority of private equity and real estate procurements was fortunately vetoed by Governor Baker "...because it authorizes the state's many retirement systems to engage in follow-on investments without the protection afforded by up-to-date due diligence". That veto was not overridden and the reforms, at least in regard to this issue, remain intact. However, the other measure that extended the period in which a search must be undertaken from five to seven years is now law. Unfortunately that action limits competition for retirement board business.

There is no question that a segment of the pension community is frustrated by the reform of the Massachusetts marketplace. We will remain vigilant and strongly urge all of those who have the best interests of members, retirees and taxpayers in mind to join us in resisting efforts to further weaken reform.

COMMISSION/STAFF CHANGES

Chairman Brown has reviewed the comings and goings of Commission members over the course of the last year. On behalf of the staff I would like to express our thanks to, and our admiration for, former Commissioners Gerry McDonough, John Langan and Liz Fontaine. Each of these individuals through their good nature, enthusiasm and expertise inspired us to our best efforts and contributed to PERAC being a pleasant place to work.

Similarly, in the relatively short time that Commissioners Kathleen Fallon, Jennifer Sullivan and Timothy Dooling have served, we all sense their dedication, interest and

good will. In combination with "old hands" Chairman Brown and Commissioners Robert McCarthy, James Machado, and Kate Fitzpatrick, the Commission is well positioned for continued success.

Staff changes also took place during the year. Caryn Shea joined PERAC in the role of Chief Auditor in the wake of Harry Chadwick's decision to return to Western Massachusetts as a Field Auditor. Caryn has extensive auditing experience and worked her way up from Field Auditor to Quality Assurance Manager in the Office of the State Auditor. In addition she is familiar to the public pension community having served on the Shrewsbury Retirement Board since 1996. Scott Henderson was appointed as Deputy Chief Auditor. It is hard to believe but Scott, a favorite of Board administrators, has been with PERAC for nearly twenty years, first, in the Actuarial Unit and, more recently, in the Audit Unit. Scott assumes the position vacated by the retirement of Jim Tivnan.

Vacant positions in the Audit Unit were also filled with the hiring of Amy Chow, George Nsia, and Kevin McCarthy. Amy is an attorney with previous experience as an investigator for the MCAD as well as in financial accounting. She is in the process of becoming a CPA. George holds a Master's Degree in Financial Economics and has over seventeen years of Accounting and Auditing experience. Most recently George worked as a staff auditor with a private sector audit firm. Kevin has served as the Chief Financial Officer of the City of Boston Credit Union, University Credit Union and Tremont Credit Union. He is a CPA with over twenty five years of experience in public accounting and private industry.

Another excellent addition to PERAC staff is Samantha MacMillan, Actuarial Analyst. Samantha is a graduate of Nichols College with a degree in Mathematics and is taking the actuarial examinations in order to become an Enrolled Actuary.

FEE REPORT

PERAC published the first in the nation compilation of the fees paid by the pension systems to investment vendors. The report consisted of the Schedule 7 filed by each Board as part of its Annual Statement of Financial Condition. According to these submissions (some of which were incomplete) local systems paid \$150,635,711.00 to investment service providers in 2014.

The Report also stressed that Schedule 7 fees represented one source of cost to Boards but that other compensation in the form of "carried interest" paid to general partners, "deferred load" payments in the mutual fund context, catch up fees and other costs such as Legal Expenses and Fiduciary Insurance impact the return on investment.

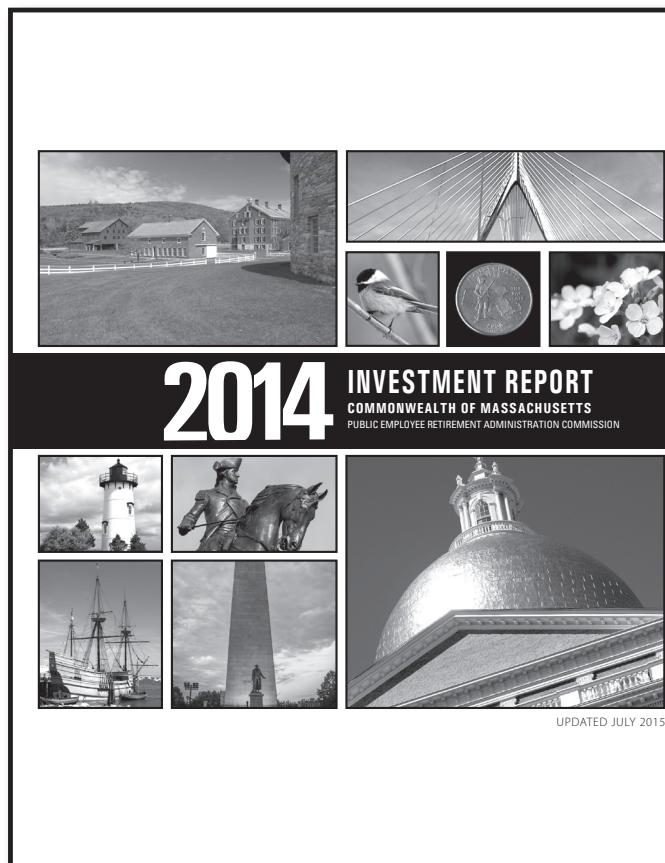
The level of cost in and of itself is neither a positive or negative but must be assessed in the context of returns as performance may justify cost.

We intend to make publication of this data an annual event.

It should also be emphasized that retirement boards must conduct their own analysis of the fees paid or expected to be paid in connection with investment activities. Over the last few years our analysis has found that service providers often are unclear about not only the costs to the system but also the manner in which payment is made.

Some arrangements include a payment directly from the Board as

well as a reduction of the value of the Board account. The latter, at least in one instance, has been misleadingly identified as a "rebate".



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EMERGING ISSUES FORUM

PERAC held its Eleventh Emerging Issues Forum at the College of the Holy Cross in September 2015. Over 260 people participated and board members attending received three educational credits. The keynote address by Treasurer Deborah Goldberg underscored her commitment to the public pension community. The Treasurer was well received as she mingled with attendees following her remarks. Glenn Doggett of the Chartered Financial Analyst (CFA) Institute kicked off the presentations with a discussion entitled "Alignment Principles from Trustee to Manager". Mr. Doggett stressed the importance of ethics and subscribing to a code of standards as Board members but also the duty of the Board to insist that investment vendors follow those standards. Evan Tylanda of the Sustainability Accounting Standards Board (SASB) addressed the topic of "Sustainable Investing: Investing for the Greater Good".

Following that session a panel discussion of OPEB chaired by PERAC Commissioner and



State Treasurer Deborah B. Goldberg delivers the keynote speech.

Needham Town Manager Kate Fitzpatrick took place. Scott McIntire of Melanson Heath used his presentation "The Auditor's Experience: The Real Impact of Governmental Accounting Standards Board (GASB) 74 & 75" to highlight changes resulting from those pronouncements and how Boards should deal with these issues. Daniel Rhodes of the Segal Company provided the attendees with an actuary's perspective with "How Working With The Actuary Can Help Municipalities Make Progress Toward Funding OPEB". His remarks noted that GASB 74 & 75 do not address funding which is a local policy decision. He reviewed funding examples and the world before and after GASB's action. Paul Todisco of PRIM explained the operation

of the State Retirees Benefits Trust and the investing options available to Boards in managing funds set aside for future costs. Following lunch a session on Media/Crisis Relations, "How to React and Respond!" with Joe Shortleeve of the Liberty Group and Ashley McCown of Solomon, McCown & Company outlined the do's and don'ts of media relations particularly when the topic is bad news. The examples provided and the insights offered made this a highlight of the day. The Forum concluded with PERAC Communications Director Natacha Dunker and a sneak preview of PERAC's new website. Natacha's hands on instruction was well received and ensured a warm reception for the new web site.

A word must be said about the participation of the board members and others at the Forum. In particular Board Member Kenneth Hartwell of Andover made a lasting impact on PERAC Commissioners, staff, Board members and presenters. His brief questions and extensive commentary stood out and made for an unforgettable event.



Kate Fitzpatrick, PERAC Commissioner and Needham Town Manager chaired the panel discussion of OPEB.



Joe Shortleeve from the Liberty Square Group talks about the Media and Crisis Relations.

WEB SITE/COMMUNICATIONS

As referenced at the Emerging Issues Forum, last fall we completed the transition to the new website now located at the Mass.gov portal. The new website makes information easier to locate, uses up-to-date technology, and enables us to continuously update its content. One of the most gratifying aspects of working this through was the enthusiastic response of retirement board members and staff to our request for comments as to how best to organize the site. That input is reflected in the final product.

It is hoped that as we go forward the website will be a platform for the dissemination of new and current information. With that in mind if you have suggestions or comments, please contact the Communications Unit at nadunker@per.state.ma.us.

Following close behind the upgrade of our Website, during this past year the Commission embarked on an ambitious IT overhaul of its current systems. Through a competitive process the Commission selected a Massachusetts firm, Collaborative Consulting to achieve our goal of improving the system's capabilities and creating more efficient business processes for both PERAC and our Stakeholders through the use of self-service portals, electronic signatures and a centralized database. Although the timetable for completion has not been finalized as we go to print, we firmly believe that following a

reasonable learning curve period a dramatic simplification of our interaction with board administrators, board members, and vendors will be achieved.

REGULATIONS

The long process of revising PERAC regulations pertaining to disability and retirement board elections was completed with the publication of the regulations in the Code of Massachusetts Regulations on March 11, 2016. Because of the unique nature of the PERAC regulation process it took more than eighteen months between the commencement of that process and the publication.

Disability changes focused on the clarification of medical panel reports and attendance at those panels. Also, the disability regulations make it clear that all voting members of a board must sign each disability transmittal sent to PERAC. Failure to do so will result in remand. In the area of 91A filings PERAC may now waive the annual filing of earnings for a retiree on disability for twenty or more years who has not reported any earnings for ten years.

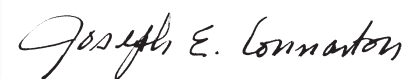
Election changes pertained to clarifying the voting rights of inactive members, definitions, and eligibility to serve among other issues.

CONCLUSION

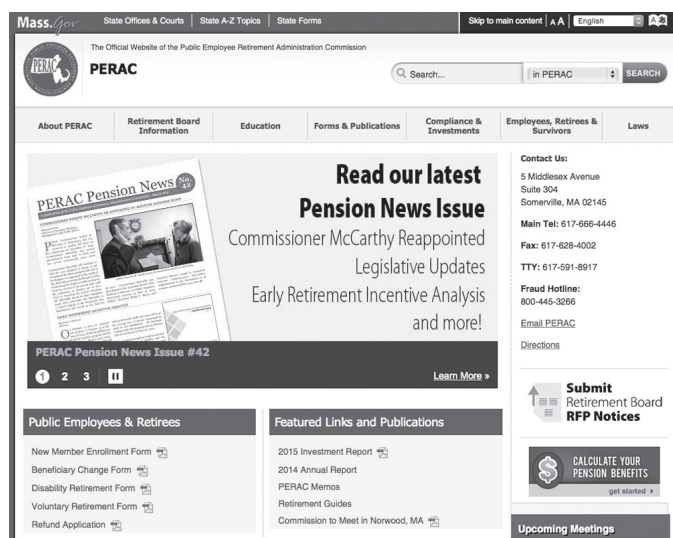
Although investment returns in 2015 again generally mirrored the markets and the experience of the retirement boards around the country, returns for 2015 were well below the actuarial assumptions. However long term returns remained in general above assumptions and as assumptions are being reduced we are better positioned for the future.

Unfortunately, as noted above, we do not operate in a vacuum. Action or inaction by unrelated pension funds can generate criticism of all public pension funds. Trends elsewhere are misinterpreted and applied to the unique circumstances of Massachusetts. Nonetheless we must rededicate ourselves to meeting the challenges ahead and ensuring that the interests of system members and their beneficiaries as well as the taxpayers are paramount. It is that goal which unites us all, the regulator and the regulated, as we move forward.

Sincerely,



Joseph E. Connarton
Executive Director



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