



Letter From the Executive Director

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The Commission and staff are pleased to release this Annual Report on the Massachusetts Public Retirement Systems for 2018. Retirement Board investment performance suffered from general market conditions but shared the same fate as most other investors. This experience supports the actions taken by the Commission in gradually reducing the investment return assumptions used in conducting actuarial valuations of the systems. 2018 also brought dramatic changes to the administration of PERAC as the long-time Executive Director, Joe Connarton, announced his retirement. Not only the public pension community, but public employees and their beneficiaries as well as taxpayers, owe thanks to Joe for his steady stewardship and clear-eyed leadership. PERAC's Mission Statement defines the “professional, prudent, and efficient administration” of the retirement systems as the Commission's “public trust”. That trust was epitomized by Joe's years of dedicated service.

Investment returns in 2018 did not achieve the lofty levels of previous years. As must be expected, capital market performance fluctuates and is influenced by many diverse factors. That performance in large part determines the return for our retirement systems. In light of that fact, PERAC has led the way in the detailed analysis of investment return projections and the application of those projections to the Massachusetts public pension plans. The steady trend of tempering expectations by lowering the investment assumption has positioned our system well for the present and future market environment. As recently as 2003, the investment return assumption for 30 of our plans was 8.50%. Today, no plan is using that assumption. In 2003 all assumptions were 7.50% or greater with only 3 between that level and 7.90%; 52 at 8.00%; 20 between 8.10% and 8.25%; and, as noted, 30 used an assumption of 8.50%. Today, 52 plans use an assumption under 7.50%; 102 use an assumption less than 8.00%; and only 2 use an assumption of 8.00%. No plan uses an assumption

greater than 8.00%. PERAC's evolutionary approach to addressing the investment return assumption has assured that funding progress continues while moderating the fiscal impact of pension costs on state and municipal budgets.

Commission/Staff Update

Most of you are aware that 2018-2019 has been a period of transition at PERAC. Executive Director Joseph Connarton, Actuary James Lamenzo, Senior Investment Analyst Victoria Marcorelle and Director of Strategic Management/Legislative Affairs Michael DeVito all retired.

Following my appointment as Executive Director, I conducted a review of PERAC's organizational structure. That review has led to some modifications in job duties as well as Unit management. These changes reflect a determination that after over twenty years of existence some adjustments were necessary, and seek to maximize our administrative experience.

Caroline Carcia has been appointed as Deputy Executive Director of Administration. In many ways, this simply recognizes the role Caroline has played at PERAC for many years. Joseph Martin's position has been reclassified as Deputy Executive Director for Policy. In that role, Joe's oversight will expand to include several PERAC Units in addition to those that have been his responsibility. Judith Corrigan has been appointed to the position of General Counsel, filling the position vacated with my appointment as Executive Director. She will manage all aspects of PERAC's Legal Unit. Patrick Charles has been promoted to Senior Associate General Counsel. In addition to his legal duties Patrick is now PERAC's liaison to the Legislature.

In the Actuarial Unit, John Boorack has assumed the position of Actuary in the wake of the retirement of Jim Lamenzo. As you know, John has been a senior member of PERAC's Actuarial team for 20 years, and is a worthy successor to Jim.

Other organizational changes included the designation of Cheryl Johnson as Compliance/Investment Data Coordinator. Cheryl, in addition to her Compliance Unit assignments, will work with the Investment Unit in calculating the annual investment performance of the retirement systems.

A vacant position in the Audit Unit was filled with the hiring of Karen Casper. Karen previously worked at Crown Castle Fiber LLC as a Tax Analyst. Sarita Yee filled an open position in the Investment Unit as a Senior Investment Analyst. Sarita has extensive experience, having worked at Brown Brothers Harriman initially as a Supervisor of the Client Service Group and most recently as the Team Leader of that Group.

Auditing

At its meetings of March 13, 2019 and April 10, 2019, the Commission discussed and ultimately approved a new and more efficient approach to the auditing of retirement systems by PERAC. The basis of that new approach is a risk-based model designed to fulfill the Commission's audit obligations in a timely, efficient and comprehensive manner. Each retirement system will be assessed and rated based on objective criteria to determine the areas of emphasis for an upcoming audit. In addition, the new approach will focus on working with private auditors who have conducted a review of systems to eliminate duplication and enhance focus.

In short, the risk-based approach will (1), target high risk areas; (2), avoid duplication with private audit work; and (3), produce more timely and substantive reports. The methodology will assess the following categories:

1. **Independent Audits** – Did the Board have an independent audit in each of the relevant years? If so, what were the issues/findings, if any?
2. **Stability/Staff Changes** – Length of tenure of the Administrator, staff, and Board. Has there been turnover in key positions during the audit period?
3. **Prior PERAC Audits** – What were the results of the previous audit, taking into account the number and significance of the issues found?
4. **Annual Statement Reviews** – What were the results of the PERAC review of the system's Annual Statement for each year of the audit period? Were the Annual Statements submitted timely or were extensions granted?
5. **Other PERAC Units** – Have activities/issues pertaining to the system been of concern to other PERAC Units?
6. **Management of Investments** – How is the Board managing its investments? Does the Board retain a consultant and multiple managers? Are assets invested partially or totally with PRIT? Did a prior audit finding pertain to investment activities?

Based on this analysis, the scope of the audit plan for the system will be developed.

Litigation Matters

A CRAB decision issued in July 2018, *O'Leary v. Lexington Retirement Board and PERAC*, CR-15-30 ("O'Leary"), rejected PERAC Memorandum #39 of 2012, regarding "Regular Compensation Status of Payments Made in Lieu of Taking Vacation Leave." Both PERAC and the member involved, Joseph O'Leary, have filed appeals of the CRAB decision in Suffolk Superior Court, so the CRAB decision is not final. As a result, PERAC initially instructed retirement boards to continue to evaluate all existing vacation buyback plans pursuant to Memorandum #39 which outlined steps that a retirement board should take to determine if payments of unused vacation time could be includable in a member's regular compensation. Memorandum #39 utilized the new definition of regular compensation as inserted into Chapter 32 by Chapter 21 of the Acts of 2009. Focusing on that definition, the memorandum explained how a retirement board should analyze the regular compensation status of such a payment, focusing on the term "other base compensation" and whether this type of payment would have resulted in a service to the employer. CRAB has now explicitly rejected this approach.

Mr. O'Leary was a police officer in Lexington who had availed himself of a vacation buyback program. The Lexington Retirement Board declined to consider whether those payments were regular compensation. CRAB has now found that this sort of payment can never be regular compensation because, in its view, such payments are not base compensation, are not payments for a service to the employer, are not "pre-determined and non-discretionary," and are in the nature of a salary augmentation plan and overtime.

If CRAB's decision in O'Leary is ultimately upheld, it will mean that any payments made to a member in lieu of that member taking vacation leave should not be considered regular compensation, and that any payments made in lieu of vacation time would not be included in a member's retirement allowance. If these appeals are not successful, it is possible, depending upon the wording of the ultimate decision, that all payments made pursuant to such a buyback program would be excised from regular compensation retroactively, any deductions paid by the member returned to him/her, and any retirement allowances granted with the inclusion of such time would be recalculated.

Boards are reminded that payments for unused sick time have never been considered regular compensation, as memorialized in the recent CRAB decision of *Fair v. Middlesex County Retirement Board*, CR15-294 (2016).

In light of the consequences of immediate implementation of this decision and the implications of taking action relative to retroactive application of its directives, PERAC filed an Emergency Motion for Stay with CRAB, arguing that the potential for disruptive changes during the pendency of the appeal necessitated a stay of enforcement. Following its review of PERAC's Emergency Motion for Stay and the Lexington Retirement Board's opposition to PERAC's motion, CRAB issued an Order of Partial Stay dated November 6, 2018. In the Order, CRAB stated:

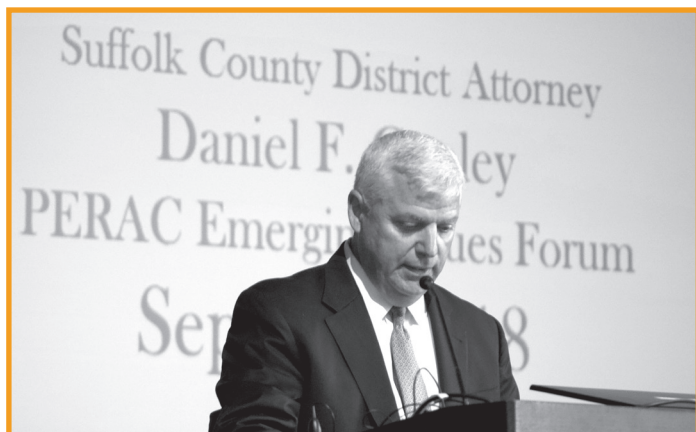
“We consider the potential for disruptive administrative changes during the pendency of judicial review to be a serious matter. PERAC and the retirement boards rely on clear rules so that they may properly and expeditiously administer the collection of contributions and the payment of benefits in the correct amounts. Thus, to the extent that our decision may require correction of past actions by retirement systems, we agree that such correction may await the completion of judicial review. As to future actions, however, we consider it wiser to require retirement systems to comply with our decision, so as to avoid a compounding of errors.”

Accordingly, pursuant to our authority under G.L. c. 30A, § 14(3), we issued a partial stay of enforcement of our decision in this matter, pending the completion of judicial review, and subject to any further order by the Superior Court or appellate court, as follows:

- 1. Retired Members.** Enforcement of our decision shall be stayed insofar as it would require recalculation of retirement benefits currently being paid to retired members, or refunding of past retirement contributions made by retired members. As to retirees, the status quo may remain in effect pending completion of judicial review.
- 2. Active Members.** Enforcement of our decision shall be stayed only insofar as it would require refunding of retirement contributions previously made by active members prior to retirement. No stay shall be in effect as to retirement contributions to be made in the future by active members. Going forward, no retirement contributions shall be collected on unused vacation pay.
- 3. Pre-Retirement Inactive Members.** Enforcement of our decision shall be stayed pending the completion of judicial review, insofar as it would require refunding of retirement contributions previously made by members inactive, prior to their retirement.
- 4. Future Retirees.** No stay shall be in effect as to the calculation of benefits to be paid to persons retiring in the future. Calculation of benefits to future retirees shall not include unused vacation pay, and any retirement contributions made on unused vacation pay shall be returned at the time of retirement.
- 5. Petitioner-Appellant.** No stay shall be in effect as to the Petitioner-Appellant Joseph O'Leary. O'Leary's retirement benefits have been calculated without the inclusion of unused vacation pay, and that calculation shall remain in place pending appeal.
- 6. Timing of Stay.** This stay shall be in effect until the completion of judicial review, unless modified by a court of competent jurisdiction.

Emerging Issues Forum

PERAC held its Fourteenth Emerging Issues Forum at the College of the Holy Cross in September, 2018. Over 240 people participated and board members attending received three educational credits. In the keynote address, former Suffolk County District Attorney Dan Conley reflected on the changes to Boston's crime landscape during his fourteen years of service in that position. His perspective provided attendees with a thoughtful and informative review of that history as well as a summary of present challenges in the criminal justice area.



Suffolk County District Attorney Daniel F. Conley was the keynote speaker at PERAC's 14th Emerging Issues Forum

Larry Stone of Stone Consulting, Kathy Riley of Segal, and PERAC Actuary Jim Lamenza, opened the proceedings with a presentation on Risk. Jim noted that actuarial best practices require that a review of the level of the various risks associated with pension management be part of actuarial valuations. These risks include obvious ones, such as the likelihood that the investment return assumption will not be met, to more subtle risks such as the possibility that the plan sponsor will not make the appropriations demanded by the funding schedule. Each panelist provided insight into the nature of these risks, how boards can assess that risk, and the impact of risk on funding.

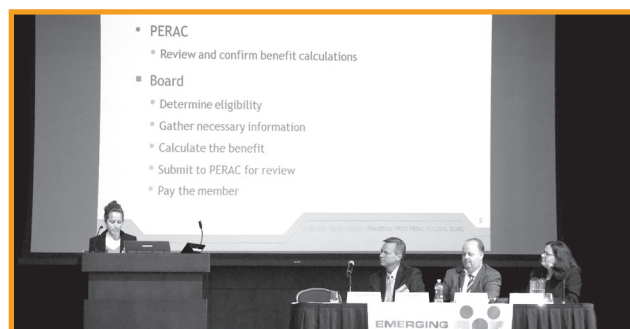


Jim Lamenza leads the Risk panel with Larry Stone and Kathy Riley at the Emerging Issues Forum.

Attendees also heard a lively discussion of the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP), two provisions of federal law that impair the ability of public retirees to receive the full benefit of Social Security. Sean Neilon of the Teachers' Retirement System and Shawn Duhamel of the Mass Retirees gave an update on the efforts of those organizations to attain legislative relief at the federal level, while Steve Richardson of the Social Security Administration, detailed the background and history that led to the adoption of GPO and WEP.

O'Neill & Associates' Senior Vice President Andy Paven and Vice President Suzanne Morse presented "Communications Crash Course." Attendees were introduced to approaches on how to deal with the media and how to make sure that your message gets across.

A centerpiece of the Forum once again was the Retirement System Best Practices panel. The Panel featured four executive directors who delved into the nuts and bolts of running a retirement system. Kaitlyn Doucette, Director of the Methuen Retirement System, who had been employed previously at PERAC as an Actuarial Analyst, reflected on the differences between working for the regulator and then working for an entity regulated by her previous employer. Chuck Kostro, of the Essex Regional Retirement System, presented on how to use the administrative budget as a communications tool to increase transparency and gain public trust. Timothy Smyth, of the Boston Retirement System, discussed the Public Records Law as recently amended and suggested strategies for better compliance. Wrapping up, Lynn Whynot, Director of the Wellesley Retirement System focused on the need for attention to small details when running a local system. She provided several approaches that can be replicated throughout the systems to improve efficiency and reduce risk.



Retirement System Best Practices segment of Emerging Issues, featuring Kaitlyn Doucette, Chuck Kostro, Tim Smyth, and Lynn Whynot

A highlight of the program was the presentation by PERAC Chairman Phil Brown to Executive Director Joe Connarton commemorating his pending retirement.

Legislation

On the legislative front, 2019 saw the adoption of legislation recommended by the Commission that addressed the application of the statutory education mandates in cases where a board member is unable to fulfill that requirement due to hardship. Chapter 439 of the Acts of 2018, "An Act Providing For Continuing Education Credits Flexibility," amended Chapter 32, Section 20(7) to enable a retirement board member to petition PERAC for a waiver of training restrictions due to extenuating circumstances. The Commission has implemented the statute and issued "An Application for a Waiver of Education Restrictions." Such circumstances must be unexpected, beyond the board member's control, and have a significant impact on the ability to complete the educational requirements. The Application for Waiver Form accompanied PERAC Memo #15-2019.

Cash Book Submissions

840 CMR 4.00 establishes methods of accounting for retirement boards. PERAC has created the email address **percashbooks@per.state.ma.us** for the submission of monthly Cash Books. It is hoped that this formal submission process will create a more efficient method for the receipt and analysis of Cash Books.

Board members and Administrators are once again reminded that a complete Cash Book package must be provided to PERAC on a monthly basis. Each month, the Board Administrator must prepare a packet which consists of the items described below.

- ▶ Year-to-Date Trial Balance (TB)
- ▶ Monthly Cash Receipts (CR)
- ▶ Monthly Cash Disbursements (CD)
- ▶ Monthly Adjusting Journal Entries (AJE)
- ▶ Monthly General Ledger (GL)

Monthly Cash Books are due at PERAC within four (4) weeks of the close of the month.

Accounting standards require that transactions be accurately identified and properly classified. The parties to whom payments are made, or from whom payments are received, must be identified and all transactions must be classified in the proper account.

Consistent with the need to maintain accurate recordkeeping by retirement boards, several accounting procedures revisions came into effect in calendar year 2018. These include accounting for fees paid in conjunction with investment activity, as well as the tracking of "carried interest," "catch up payments," and "ancillary expenses" related to private equity, hedge fund, real estate, and similar investment vehicles.

Education

PERAC continued its successful education program for retirement board members in 2018. This was the seventh year of the program and included courses on "Smoothing, Spiking and Other Actuarial Mysteries," the popular "Chapter 32 in a Nutshell," "PROSPER Update," and "Non-Investment Related Procurement."

We were particularly excited by the initiation of courses offered through webinar. This enables attendees to participate from their computer rather than traveling to a specific location. We are hoping to expand these opportunities in the years ahead.

Expanding our program of one day Board Administrator Trainings, in 2018 sessions were held in Northampton, Framingham, and Norwood. Sessions were very well attended. Members of the Actuarial, Compliance, and Legal Units at PERAC served as presenters. Many topics were covered in the course of each session. Attendees learned about "Alternative Investment Accounting," "The 91A Process," "Veterans Benefits," "12(2)(b) Dependent Allowances," "Ordinary Disabilities," "Chapter 32 In A Nutshell," and "Special Legislation." Each day of training concluded with the awarding of certificates to all attendees. Board members who attended received three educational credits.

We are finalizing plans for similar events to be held prior to the end of this year.

Conclusion

This year has been a year of transition at PERAC, a year of steady stewardship at the retirement boards, and a year of fiscal challenge for those responsible for funding pension costs. However, the steps taken to adjust investment assumptions, modernize the interaction between PERAC and the Boards, and to engage and inform decision makers about pension issues ensure that the future of our defined benefit plan will be bright.

With that record in mind, I would like to express my personal gratitude to retired Executive Director Joe Connarton for his leadership of PERAC as well as the example he has set for me as I assume my new duties. Joe is not one to seek or accept accolades, but it is not an exaggeration to say that the condition of the retirement systems and the ability of those systems to provide for retirees and beneficiaries have been greatly enhanced by his dedicated service.

Sincerely,



John W. Parsons, Esq.
Executive Director