MEMORANDUM #16, 2014

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M E M O R A N D U M

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Follow-up on Anti-Spiking Exemptions

DATE: April 25, 2014

It has come to our attention there continues to be confusion concerning the anti-spiking provision contained in Section 18 of Chapter 176 of the Acts of 2011, specifically with regard to the exemptions dealing with salary or salary schedules negotiated for bargaining unit members under Chapter 150E and bona fide changes in position. This memorandum attempts to clarify these issues.

Section 18 states in part, "[i]n calculating the average annual rate of regular compensation for purposes of this section, regular compensation in any year shall not include regular compensation that exceeds the average of regular compensation received in the 2 preceding years by more than 10 per cent. This paragraph shall not apply to an increase in the annual rate of regular compensation that results… *from a bona fide change in position, from a modification in the salary or salary schedule negotiated for bargaining unit members under chapter 150E…*" (emphasis supplied).

<u>Salary or Salary Schedules Negotiated for Bargaining Unit Members Under Chapter 150E</u>

We have received a number of calculations in which the retiring member has an individual employment contract (as opposed to one that is collectively bargained). In some of these cases, the retirement board has attested that it has reviewed the salary for anti-spiking and that the salary meets the exemption because the member has a contract. However, note that this exemption applies only to salaries or salary schedules that are collectively bargained by bargaining unit members under G.L. c. 150E. This exemption does *<u>not</u>* apply when someone has an employment contract. To qualify for this exemption, the employee must be a member of a bargaining unit as defined in G.L. c. 150E, §3. Retirement boards must ensure that the retiring member has a contract that is collectively bargained (as opposed to an individual contract) to satisfy the requirements for this exemption.

<u>Bona Fide Change in Position</u>

Section 18 provides an exemption to the anti-spiking review when an increase in the annual rate of regular compensation results from a *bona fide change in position*. A bona fide change in position occurs when the essential duties of the position change. A simple title change in which the essential duties of the position do not change is not considered a bona fide change in position for anti-spiking purposes.

This exemption is applicable **only** in the year the member changes position. It does not provide relief for pay increases earned after (or before) the member changes position. Any pay increases that occur after (or before) the change in position are still subject to anti-spiking review. *In performing the anti-spiking review, for the year of the position change and the year after the position change, the average of the previous two years compensation will be set equal to the annual rate of the new position*. The reasoning for this interpretation is demonstrated in the following example.

To illustrate this exemption, we are providing an example with 3 approaches for the same calculation. **Each of the first two approaches is not correct and is shown for illustration only. The first approach shows a common misconception regarding this exemption. The second approach appears correct but is at odds with our understanding of the intent of Section 18**. All the figures in the first two approaches are in italics with errors shown in bold. The third approach is based on our interpretation of Section 18 and shows the impact of a bona fide change in position in the anti-spiking calculation.

In each of the three approaches that follow, Year 1(2013) is the most recent year; Year 2 (2012) is the next most recent year, etc. The annual rate of regular compensation for Year 4 (2010) and Year 5 (2009) is $70,000. At the beginning of Year 3 (2011) the member has a bona fide change in position (shaded in the charts that follow). The annual rate of the new position in 2011 is $100,000. The member receives subsequent annual raises of $25,000 (in 2012 and 2013 respectively) which do not reflect a bona fide change in position.

Example 1, Approach 1: Incorrectly Assumes Anti-Spiking Exemption if There is Ever a Bona Fide Change in Position:

The first approach correctly uses a figure of $100,000 for 2011 in column (4) due to the bona fide change in position. **However, this approach makes the incorrect assumption that if a member receives a bona fide change in position in 2011 then he/she is exempt from the anti-spiking review in 2012 and 2013. This is *not* a correct interpretation of the law. The 2012 and 2013 amounts in column (4) incorrectly ignore the calculations performed in columns (2) and (3).**

Incorrect Approach

	(1)	*(2)*	*(3)*	*(4)*
Year (calendar year)	*Compensation*	*Avg. of Previous 2 years*	*110% of Avg. of Previous 2 years*	*Compensation used*
1 (2013)	*150,000*	*112,500*	*123,750*	***150,000***
2 (2012)	*125,000*	*85,000*	*93,500*	***125,000***
3 (2011)	*100,000*	*70,000*	*77,000*	*100,000*
4 (2010)	*70,000*			
5 (2009)	*70,000*		***3-Year Average:***	***125,000***

Example 1, Approach 2: Incorrectly Reflects the Pay from the Bona Fide Change in Position when the Change Occurs in Year 3:

As mentioned earlier, any pay increases received *after (or before)* the year in which there is a bona fide change in position *are* subject to the anti-spiking review. However, in this approach, one interpretation of the statute (the compensation used in any year cannot exceed the average of the compensation received in the previous **two** years by more than 10%) leads to an anomaly in 2012. Because of the two-year look-back, the average compensation for the previous two years (column (2)) for 2012 is $85,000 and the resulting figure used in column (4) (the lesser of columns (1) and (3)) is only $93,500. This figure is less than the corresponding figure for 2011. If the member should not be penalized by the bona fide change in position, then the 2012 figure in column (4) should not be less than $100,000 (the starting pay after the bona fide change in position). Nevertheless, without making any adjustment in 2012, this is how this approach would be calculated.

Incorrect Approach

	(1)	*(2)*	*(3)*	*(4)*
Year (calendar year)	*Compensation*	*Avg. of Previous 2 years*	*110% of Avg. of Previous 2 years*	*Compensation used*
1 (2013)	*150,000*	*112,500*	*123,750*	*123,750*
2 (2012)	*125,000*	*85,000*	*93,500*	***93,500***
3 (2011)	*100,000*	*70,000*	*77,000*	*100,000*
4 (2010)	*70,000*			
5 (2009)	*70,000*		***3-Year Average:***	***105,750***

<u>Example 1, Approach 3: Correctly Reflects the Pay from the Bona Fide Change in Position when the Change Occurs in Year 3:</u>

To ensure that the member is not penalized by the bona fide change in position and to avoid the anomaly presented in the previous approach, we set column (2) equal to the compensation received in the new position for the year of the bona fide change in position (2011) and the year *after* the bona fide change in position (2012). Therefore, the correct approach based on our interpretation of the law is as follows. Note that with this adjustment, column (4) is correctly determined as the minimum of columns (1) and column (3).

Correct Approach

	(1)	(2)	(3)	(4)
Year (calendar year)	Compensation	Avg. of Previous 2 years	110% of Avg. of Previous 2 years	Compensation used (min of (1) and (3))

1 (2013)	150,000	112,500	123,750	123,750
2 (2012)	125,000	100,000*	110,000	110,000
3 (2011)	100,000	100,000*	110,000	100,000
4 (2010)	70,000			
5 (2009)	70,000		**3-Year Average:**	**111,250**

* Reflects the starting compensation of the bona fide change in position

As a final example, we will review the correct approach if the bona fide change in position were to occur in 2012 instead of 2011. For this example, we will show only Approach 3.

Example 2, Approach 3:Correctly Reflects the Pay from the Bona Fide Change in Position when the Change Occurs in Year 2:

In this example, the annual rate of regular compensation in 2009 is $60,000, and in 2010 and 2011 it is $70,000. At the beginning of 2012 (shaded in the chart below), the member has a bona fide change in position with an annual rate of regular compensation of $100,000. The member receives a subsequent raise of $25,000 in 2013, which does not reflect a bona fide change in position.

Correct Approach

	(1)	(2)	(3)	(4)
Year (calendar year)	Compensation	Avg. of Previous 2 years	110% of Avg. of Previous 2 years	Compensation used (min of (1) and (3))
1 (2013)	125,000	100,000*	110,000	110,000
2 (2012)	100,000	100,000*	110,000	100,000
3 (2011)	70,000	65,000	71,500	70,000
4 (2010)	70,000			
			3-Year	

5 (2009)	60,000		**Average:**	**93,333**

* Reflects the starting compensation of the bona fide change in position.

Please note that the worksheet that we developed as part of PERAC Memo #44/2012, was not designed to determine anti-spiking for pay received due to a bona fide change in position. Calculations with bona fide changes in position, as outlined in this memo, **cannot** use the standard worksheet. An updated version of the anti-spiking worksheet is available on the PERAC Website under the Actuarial Unit. Any retirement board that saved a copy of the original worksheet on their computers is encouraged to replace that original file with this updated file.

Retirement Boards should contact PERAC's calculation unit if they have a member who had a bona-fide change in position during the period constituting the highest three-year (or five-year if applicable) average who does not meet any of the other exceptions to correctly determine whether anti-spiking applies.

We trust the foregoing is of assistance. If you have any questions, do not hesitate to contact the calculation unit.