MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Anti-Spiking Provisions of Chapter 176 of the Acts of 2011

DATE: June 21, 2012

Spiking with regard to public pensions has been defined as the receipt by a public employee of large pay increases in the years just prior to their retirement to artificially inflate their compensation in order to receive larger pensions than they otherwise would be entitled to receive. There is no information or data available about whether this practice occurs in the Massachusetts public pension system to any great extent. Nevertheless, the Massachusetts Legislature has followed the lead of many other states and enacted what is known as "anti-spiking" legislation.

On November 18, 2011 Governor Patrick signed Chapter 176 of the Acts of 2011 into law, reforming and modernizing the pension laws for public employees in the Commonwealth. Sections 14 and 18 of this law establish anti-spiking provisions relating to a member’s regular compensation and potentially limit the amount of regular compensation that can be used in calculating his or her retirement allowance. These two sections are applicable to anyone retiring on or after April 2, 2012. Examples from each section will be shown at the end of the Memorandum. Please note that these examples are not all encompassing. PERAC is in the process of developing worksheets to help boards with these calculations. Once these worksheets are completed, boards will be notified and they will be available on our website.

We apologize for the length of this memo. Interpreting the anti-spiking provisions, both individually and in conjunction with each other, has been a daunting task.

Many Retirement Boards have sent in calculations for approval with retirement dates effective on or after April 2, 2012. These calculations were sent in without any confirmation that the regular compensation had been checked for violations of the relevant anti-spiking provisions. Boards will need to review any and all such calculations and verify to PERAC that the calculations have been reviewed for anti-spiking. For those boards that have been granted a waiver for submitting superannuation calculations, the Board will either need to attest that the pay has been reviewed pursuant to the anti-spiking provisions or submit said calculations to PERAC for review.

The provisions of sections 14 and 18 offer two completely different methodologies in determining whether regular compensation has spiked. The retirement allowance of a member who retires on or after April 2, 2012 must be analyzed under both sections. Such a member's allowance could be found to violate either Section 14 or Section 18, or both. If a member receives salary or compensation increases in excess of these statutory limits, the years to be utilized in the calculation may be modified to as to prevent an artificially inflated benefit calculation.

Section 14 of Chapter 176 of the Acts of 2011

Please refer to Section 14 which amends G.L. c. 32, §5(2)(a) and states in pertinent part:

> …[I]f in the 5 years of creditable service immediately preceding retirement, the difference in the annual rate of regular compensation between any 2 consecutive years exceeds 100 per cent, the normal yearly amount of the retirement allowance shall be based on the average annual rate of regular compensation received by the member during the period of 5 consecutive years preceding retirement.

The method outlined in Section 14, whereby increases in compensation of more than 100% (compensation that more than doubles) in any 2 consecutive years of creditable service during the 5 years of creditable service immediately preceding retirement will require that superannuation allowances (and other benefits which are calculated pursuant to the provisions of G.L. c. 32, §5; Sections 6 for non-veterans, 10(1) and 12(2)(d)) be calculated using the average of the last 5 years of regular compensation. Boards need only look at the last 5 years of creditable service when determining whether there is a violation of Section 14. Please note that for any member found in violation of Section 14, the new law requires that his/her retirement benefit be based on the average of the regular compensation for the last five years of creditable service, even if he/she had three consecutive years of regular compensation earlier in their career that would otherwise be higher.

For someone who first became a member of a retirement system on or after April 2, 2012, his/her allowance would already be calculated using an average of five consecutive years of regular compensation. Boards would still need to perform this check. If such a member is found to violate the provisions of Section 14, his/her benefit would need to be calculated using the average of the last five years of regular compensation, even if he/she had five consecutive years of regular compensation earlier in his/her career that would be higher.

Section 18 of Chapter 176 of the Acts of 2011

Please refer to Section 18 which amends G.L. c. 32 by adding §5(2)(f) and states:

> (f) In 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 an increase in hours of employment, from overtime wages, from a bona fide change in position, from a modification in the salary or salary schedule negotiated for bargaining unit members under chapter 150E, or in the case of a teacher, from the performance of any services set forth in the third sentence of the first paragraph of the definition of "regular compensation" in section 1. Any withholdings excluded from the calculation of a member's average annual rate of regular compensation under this paragraph, shall be returned to the member with interest at the assumed actuarial rate.

The method outlined in Section 18 provides that the regular compensation in any year which exceeds the average of the 2 preceding years by 10% or more cannot be used in determining the average salary used in calculating a superannuation retirement benefit (or other benefits which are calculated pursuant to the provisions of G.L. c. 32, §5; Sections 6 for non-veterans, 10(1) and 12(2)(d)). These provisions shall not apply if the increase in regular compensation results from one of the following:

1) an increase in the number of hours worked,
2) overtime wages *
3) a bona fide change in position
4) a modification in the salary or salary schedule negotiated for bargaining unit members of Chapter 150E, or
5) for only teachers, the performance of any service set forth in the third sentence of the first paragraph of the definition of "regular compensation".

** Note: Overtime wages are not considered regular compensation under Chapter 32, but were included as part of Section 18 of Chapter 176 of the Acts of 2011.*

It should be noted that it does not take a significant increase in regular compensation to trigger a violation under this section. A member who receives an increase in regular compensation of

6.6% for two consecutive years will have regular compensation that exceeds the average of the previous two years by more than 10%.

If a member is found to violate the provisions of Section 18, then a retirement board would need to determine the amount of the contributions the member made on regular compensation above and beyond the regular compensation used in determining his or her benefit. These excess contributions would be refunded to the member along with interest at the assumed actuarial rate used in a system's most recent actuarial valuation. Please note that this refund would be subject to the additional 20% withholding because these contributions are pre-tax contributions.

If a member is found to violate both section 14 and section 18, then the benefit would be based on the last 5 years of creditable service as provided for in Section 14 and the regular compensation would need to be adjusted as provided for in Section 18. (See Example 5)

Examples

Section 14 Anti-Spiking

Example 1: A member is elected and serves on a city council for 20 years and receives an annual rate of regular compensation of $10,000. The member is elected mayor and serves for one three-year term at an annual rate of regular compensation of $100,000. In this example, it is assumed that all elected terms expire on December 31. The member retires effective January 1, 2013 (immediately after the term of mayor expires). The last 5 years of regular compensation are as follows.

2012	$100,000
2011	$100,000
2010	$100,000
2009	$10,000
2008	$10,000

The retirement board needs to review the regular compensation received during the last five years of creditable service. In this example, the regular compensation between 2009 and 2010 increases by more than 100%, so therefore, the retirement board would need to calculate this benefit based on the average of the last five years of regular compensation. In this instance, the average regular compensation used in calculating the superannuation allowance would be $64,000 ($320,000 / 5). Prior to the passage of Chapter 176, the average regular compensation would have been $100,000.

Note that this calculation does not violate the provisions of Section 18 of Chapter 176 of the Acts of 2011, because the increase in pay was due to a bona fide change in position.

Example 2: A member is elected and serves on a city council for 20 years and receives an annual rate of regular compensation of $10,000. The member is elected mayor and serves for one three-year term at an annual rate of regular compensation of $100,000. After the term of mayor expires, the member is elected to and serves on the city council for two additional years at an annual rate of regular compensation of $10,000. In this example, it is assumed that all elected terms expire on December 31. The member retires effective January 1, 2013 (immediately after the term as city councilor expires). The last 6 years of regular compensation are as follows.

2012	$10,000
2011	$10,000
2010	$100,000
2009	$100,000
2008	$100,000
2007	$10,000

The retirement board needs to review the regular compensation received during the last five years of creditable service. In this example, the regular compensation between any two consecutive years during the last 5 years of creditable service does not increase by more than 100%, so therefore, this member is not affected by this section. The average salary used in the calculation would be $100,000 (the average of 2008-2010). Please note that the regular compensation between 2007 and 2008 increases by more than 100%, but this falls outside the range of the last 5 years of creditable service.

Also note that this calculation does not violate the provisions of Section 18 of Chapter 176 of the Acts of 2011, because the increase in pay was due to a bona fide change in position.

Example 3: A member is elected and serves on a city council for 20 years and receives an annual rate of regular compensation of $10,000. The member loses his seat on the city council after 2007. Two years later the member is elected mayor and serves for one three-year term at an annual rate of regular compensation of $100,000. In this example, it is assumed that all elected terms expire on December 31. The member retires effective January 1, 2013 (immediately after the term of mayor expires). The last 5 years of regular compensation are as follows.

2012	$100,000
2011	$100,000
2010	$100,000
2007	$10,000
2006	$10,000

The retirement board needs to review the regular compensation received during the last five years of creditable service. In this example, the regular compensation between 2007 and 2010 (two consecutive years of creditable service) increases by more than 100%, so therefore, the Retirement Board would need to calculate this benefit based on the average of the regular compensation received during the last 5 years of creditable service. In this instance, the average regular compensation used in calculating the superannuation allowance would be $64,000 ($320,000 / 5). Prior to the passage of Chapter 176, the average regular compensation would have been $100,000.

Note that this calculation does not violate the provisions of Section 18 of Chapter 176 of the Acts of 2011, because the increase in pay was due to a bona fide change in position.

Section 18 Anti-Spiking

Example 4: A member retires on June 1, 2012 and has regular compensation according to the following table. Assume that the increase in regular compensation is not due to any of the statutorily provided exceptions.

Time Period	(1) Actual Pay for the Period	(2) Average of Previous 2 Years	(3) 110% of Avg. of Previous 2 years 1.1 x column (2)	(4) Pay used to calculate benefit lesser of columns (1) & (3)
6/1/11 - 5/31/12	$50,000	$42,500	$46,750	$46,750
6/1/10 - 5/31/11	$45,000	$39,500	$43,450	$43,450
6/1/09 - 5/31/10	$40,000	$38,000	$41,800	$40,000
6/1/08 - 5/31/09	$39,000			
6/1/07 - 5/31/08	$37,000			

The retirement board would need to review the regular compensation received during the last five years of creditable service to determine whether the three-year average salary should be adjusted. In this example, the regular compensation for the period from June 1, 2011 to May 31, 2012 is $50,000. The average regular compensation of the previous two years (June 1, 2009 through May 31, 2011) is $42,500. The actual regular compensation exceeds the average of the previous two years by more than 10% so the board would adjust the regular compensation used for this period when calculating the average salary. The adjusted regular compensation for this period would be $46,750 which is 110% of the average of the regular compensation for the previous two years. The board would repeat this exercise for the periods June 1, 2010 through May 31, 2011 and June 1, 2009 through May 31, 2010. The average salary used to determine the retirement benefit would thus be $43,400 [($46,750 + $43,450 + $40,000) / 3].

In the example above, the member's allowance was calculated based on the average of three consecutive years of regular compensation. Therefore, the period of consideration is the last five years. If the allowance is for someone who became a member on or after April 2, 2012 and whose allowance would be calculated based on an average of five consecutive years of regular compensation, the period of consideration would need to be the last seven years.

Example 5 (This member violates both section 14 and section 18): A member is elected and serves on a city council for 20 years and receives an annual rate of regular compensation of $10,000. In 2010, the rate of regular compensation for city councilors is increased to $21,000. The member retires effective January 1, 2013. The last 5 years of regular compensation are as follows.

2012	$21,000
2011	$21,000
2010	$21,000
2009	$10,000
2008	$10,000

Under section 14, the retirement board needs to review the regular compensation received during the last five years of creditable service. In this example, the increase in the rates of regular compensation between 2009 and 2010 exceeds 100%, so therefore, the retirement board would calculate the benefit based on the average of the last five years of regular compensation. However, since the increase in pay is not due to one of the statutory exceptions found in section 18, the board needs to adjust the regular compensation pursuant to section 18, but using a 5-year average period required by violating section 14.

Time Period	(1) Actual Pay for the Period	(2) Average of Previous 2 Years	(3) 110% of Avg. of Previous 2 years 1.1 x column (2)	(4) Pay used to calculate benefit lesser of columns (1) & (3)
1/1/12 – 12/31/12	$21,000	$21,000	$23,100	$21,000
1/1/11 – 12/31/11	$21,000	$15,500	$17,050	$17,050
1/1/10 – 12/31/10	$21,000	$10,000	$11,000	$11,000
1/1/09 – 12/31/09	$10,000	$10,000	$11,000	$10,000
1/1/08 – 12/31/08	$10,000	$10,000	$11,000	$10,000
1/1/07 – 12/31/07	$10,000			
1/1/06 – 12/31/06	$10,000			

The average salary to be used in calculating this member's allowance would thus be $13,810 [($21,000 + $17,050 + $11,000 + $10,000 + $10,000) / 5].

We trust the foregoing is of assistance. Any questions you may have regarding this topic should be addressed to the Actuarial/Calculation Unit.