

MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Regular Compensation status of payments made in lieu of taking vacation leave

DATE: July 11, 2012

This memorandum supersedes PERAC Memorandum #25/2000, which was issued on June 8, 2000, and PERAC Memorandum #26/2000, which was issued on June 28, 2000. These superseded Memoranda were concerned with payments made in lieu of vacation and personal days. The analysis as set forth in this memorandum involves only payments related to the selling back of vacation time by an employee as a result of that employee not using that vacation time, as fully explained below.

Excluded from the purview of this memorandum are payments made in lieu of taking sick leave, personal leave, or other leave which is granted as time off for specific events, (i.e., illness, bereavement,) for which the employee by definition would be unable to appear for work. If an employee actually takes such time when they are eligible to take it, the payment would of course be regular compensation. It is important to note that vacation benefits, unlike other earned time benefits, are expressly defined as wages in Section 148 of Chapter 149 of the General Laws.

The term “leave,” as used in this memorandum, shall refer only to vacation time or vacation leave. The term “payments,” as used in this memorandum, shall refer only to payments made in lieu of taking vacation time or vacation leave to which a member is entitled. The terms “vacation leave” and “vacation time” shall be interchangeable.

The term “participate” shall mean receiving a payment in lieu of taking vacation time or vacation leave, and making retirement contributions upon that payment.

Payments must only be for unused vacation time actually earned during a 12-month period for which such purchase is authorized.



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It is important to note Chapter 21 of the Acts of 2009 changed the definition of “regular compensation.” That legislation was followed by the promulgation of new PERAC regulations regarding regular compensation, which may be found at 840 CMR 15.03(3). Finally, Chapter 176 of the Acts of 2011 contains provisions that direct retirement boards to maintain copies of all collective bargaining agreements on site and to “...review collective bargaining agreements for compliance with chapter 32”.

The Commission has carefully reviewed these changes in the law and has concluded as follows:

Retirement boards shall classify payments for unused vacation leave as regular compensation if the following analysis results in a determination by the retirement board that payments related to such vacation leave are regular compensation.

ANALYSIS OF PAYMENTS BY RETIREMENT BOARD

The payments must meet the two minimum threshold requirements of regular compensation:

1. The payments must either be part of the base salary of the employee or “other base compensation of the employee”. Payments cannot be found to be “other base compensation” if a payment is of only limited duration or if the payments lack predictability.
2. The payments must be for services performed. A retirement board would have to find that working in lieu of taking vacation is a “service performed”.

Only if a retirement board determines that the threshold requirements of regular compensation have been met would the first step of the analysis be complete. If either of the two questions above is answered in the negative, the analysis ends and the payments may not be considered regular compensation.

If a retirement board determines that the threshold requirements have been met, the board must then make findings regarding the following:

- The retirement board would need to find that such payments for unused vacation leave are not excluded by statute, regulation or case law.
- The retirement board must find that such payments are not “1 time” because they have been made year after year.
- The retirement board would need to find that such payments have not been made primarily in the last three years or for any other period of limited duration such that they

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could be considered “salary enhancements or salary augmentation plans which will recur for a limited or definite term...”

- If an individual elects to participate in a buyback program, he or she must do so in a consistent manner from year to year and in conformity with the legal restrictions of salary augmentation contained in the statute and regulations.
- The retirement board would need to find that participation in such a plan is available to all similarly situated employees.
- The retirement board would need to examine the vacation accrual arrangement in place and find that any payments made were actually earned during the 12 month period for which such purchase is authorized.
- The retirement board would need to find that such a payment has not been made as a result of giving notice of retirement.
- Payments must only be made pursuant to an official written policy of the employer, a collective bargaining agreement, or an individual employment contract that allows an employee to receive compensation in lieu of vacation time.
- Payments must be in a reasonable amount which would not cause a substantial burden on the retirement system. In making such a determination, retirement boards should consider the actuarial analysis of vacation buy backs attached hereto as Exhibit 1.
- Chapter 176 of the Acts of 2011 inserted two anti-spiking provisions into Chapter 32. If these payments under a vacation buy back plan are deemed to be regular compensation such provisions would apply in the calculation of retirement benefits.

Retirement boards should conduct this analysis on a case by case basis, reviewing the collective bargaining agreements which are now mandatorily provided to them under the provisions of Chapter 176 of the Acts of 2011.

Section 54 of Chapter 176 of the Acts of 2011 inserted the following language into Section 7 of Chapter 150E:

An employer entering into a collective bargaining agreement with an employee organization shall provide a copy of the agreement to the retirement board to which the employees covered by the agreement are members. All retirement systems shall maintain files of all active collective bargaining agreements which cover the

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systems members. The retirement board shall review collective bargaining agreements for compliance with chapter 32.

Section 37 of Chapter 176 of the Acts of 2011 inserted the following language into Section 21 of Chapter 32:

Each board shall maintain a copy of all collective bargaining agreements which cover the system's members and shall make the agreements available to the commission for review at such time as the commission shall specify.

If a collective bargaining agreement has not been provided to the retirement board as required by law, no analysis may be undertaken and the payment may not be granted regular compensation status. A retirement board shall also review official written policies and individual contracts as provided by interested parties.

The guidelines outlined in this memorandum shall take effect on July 1, 2012 and shall apply only to payments made on or after that date. PERAC Memorandum #25/2000 and PERAC Memorandum # 26/2000 shall apply to any payments occurring prior to July 1, 2012.

We trust the foregoing is of assistance. If you have further questions or concerns, please contact this office.

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EXHIBIT 1

Actuarial Analysis of Vacation Buybacks

We performed a benefit analysis of the cost of vacation buybacks. In other words, we looked strictly at the difference in the benefit and the present value of benefits for a member who retires without a vacation buyback compared to that same member electing a vacation buyback under various scenarios. We measured the increase in retirement benefit to reflect the buyback as well as the additional employee contributions under the buyback. We did not perform a cost analysis in which we would try to measure actuarial costs or the potential impact on a system's funded status or funding schedule of a vacation buyback.

It is important to note that there are a number of variables in any example that we prepare. These variables include job group, age at hire, age at retirement, service, contribution rate, salary increases during the member's career, number of weeks bought back, and the number of years of participation in the buyback program.

Example 1

Assumptions

Job group	4
Hire age	25
Year hired	1982
Retirement age	55
Service	30
2012 pay	\$70,000
Salary increases	3%
Contribution rate	7% plus 2% in excess of \$30,000
Interest rate	8.0%
Present value factor	10.61 (RP2000 Healthy Annuitant Male Table)
Member buys back 2 weeks for 15 years before retirement	
Figures rounded to nearest dollar	

Buying back 2 weeks increases the member's pay and average pay by 3.8% (54/52).

The average pay without buyback is \$67,981 [(\$70,000 + \$67,961 + \$65,982)/3]. With the buyback it is \$70,596.

The member's benefit without a buyback is \$50,986 (.025 x 30 x \$67,981). With the buyback it is \$52,947. The difference is \$1,961.

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The present value of the difference is \$20,806 ($\$1,961 \times 10.61$)

The accumulated present value of additional employee contributions for the 2 weeks bought back each year for 15 years is \$5,379.

The difference between the present value of the additional benefit and the additional accumulated contributions is \$15,427 ($\$20,806 - \$5,379$).

The percentage of the increased benefit covered by additional employee contributions is 26% ($\$5,379 / \$20,806$).

For every 100 members who participate in the program under the above scenario, the difference between the present value of the additional benefit and the additional accumulated contributions is \$1,542,700 ($\$15,427 \times 100$).

Example 2

Same as Example 1 except member buys back 2 weeks for 10 years before retirement.

The calculations of average pay and benefits with and without the buyback do not change.

Since the member participates in the buy back for only 10 years, the accumulated present value of additional employee contributions for the 2 weeks is only \$3,148.

The difference between the present value of the additional benefit and the additional accumulated contributions is \$17,658 ($\$20,806 - \$3,148$).

The percentage of the increased benefit covered by additional employee contributions is 15% ($\$3,148 / \$20,806$).

Example 3

For comparison, we determined what the percentage would be if the member had not bought back any vacation time for his/her entire 30 year career. The percentage of the entire benefit covered by employee contributions is 69%.

Example 4

Same as Example 1 except member buys back 4 weeks for 15 years before retirement.

Although the benefit increases by 7.7% (56/52) instead of 3.8%, there are also additional employee contributions and the percentage of the increased benefit covered by additional employee contributions is 26%, the same as Example 1.

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Note that although the percentage is the same as in Example 1, the difference between the present value of the additional benefit and the additional accumulated contributions is \$30,855 (twice the figure of \$15,427 shown in Example 1). This results from both the present value of the benefit increase and the accumulated value of additional employee contributions being twice the figures outlined in Example 1.

Example 5

Same as Example 2 except member buys back 4 weeks for 10 years before retirement.

Once again, the percentage of the increased benefit covered by additional employee contributions is 15%, the same as Example 2.

As in Example 4, although the percentage is the same as in Example 2, the difference between the present value of the additional benefit and the additional accumulated contributions is \$35,316 (twice the figure of \$17,658 shown in Example 2).

The length of participation in the buyback program carries the most weight in determining the calculated percentage of the increased benefit covered by additional employee contributions (26% for 15 years of participation or 15% for 10 years of participation in the examples above). If the participation period is maintained, and the retirement age and service do not vary significantly, the percentages determined are comparable.