

MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Interest Payments in Certain Situations

DATE: March 5, 2018

This memorandum concerns the payment of interest, and is intended to clarify and to complement – but not supersede – PERAC Memoranda No. 43/1999, which was issued on November 9, 1999 (regarding the 2% deduction on amounts over \$30,000) and No. 32/2013, which was issued on November 20, 2013 (regarding interest to be paid out by retirement boards in certain circumstances). Additionally, this memorandum is intended to supersede Section 3, Paragraph C of PERAC Memorandum No. 29/2016, which was issued on December 13, 2016 (regarding the buyback of call firefighter time).

This memorandum is divided into four sections. Section I addresses when interest may be payable by a retirement board to a member or beneficiary. Section II concerns those situations in which a member or beneficiary may owe interest to a retirement board. Section III is a chart setting out various scenarios which may arise, and whether or not interest would be payable in each scenario. Finally, Section IV concludes this memorandum.

PRELIMINARY NOTE

In regard to the rates of interest to be paid in certain situations, the term “correction of error” will be used in this memorandum to refer to the “actuarial equivalence,” or “actuarial equivalent” rate. This term references the interest rate which has been adopted by the majority of retirement boards in the wake of PERAC Memorandum No. 32/2013.

SECTION I

A RETIREMENT BOARD PAYING INTEREST TO A MEMBER OR BENEFICIARY

The logistics of a retirement board paying interest to a member or beneficiary on a lump sum payment were addressed by PERAC in Memorandum No. 32/2013, as noted directly above.



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That memo was in turn prompted by the Supreme Judicial Court (“SJC”) case of *Herrick v. Essex Regional Retirement Board*, 465 Mass. 801 (2013), which held that:

Therefore, we interpret [G.L. c 32,] § 20(5)(c)(2) to provide a remedy for all errors made by the board that affect the amount of benefits a member or beneficiary receives, allowing the error to be corrected so that members and beneficiaries receive the actuarial equivalent of the benefits they would have received had the board not erred. Because the board's actuary must determine an appropriate interest rate to yield the actuarial equivalent, the interest rate must be determined by the board, not the court clerk, on remand from a reversal of a board's decision under G.L. c. 30A. (Emphasis supplied.)

In the wake of Memorandum No. 32/2013, the majority of retirement boards have set a “correction of errors” interest rate which will serve as the “actuarial equivalent” when a retirement board must pay a member or beneficiary a lump sum amount which is intended to make a person whole, so that they receive no less than the benefit to which they were originally entitled.

Memorandum No. 32/2013 made clear that the *Herrick* decision also applies to errors of a retirement board which are not corrected by a Court. In the same vein, in the case of *Clancy v. State Board of Retirement*, CR-09-308 (2015), the Contributory Retirement Appeal Board (“CRAB”) recently held that “The requirement to pay interest, however, applies in cases where the retirement board has made an error, or where repayment of benefits is ordered by a court.”

So it is clear that a payment due to a member or beneficiary which affects a benefit will require the payment of interest by the retirement board. Another question arises, however, when a payment is due to a member or beneficiary which does not affect the amount of a pension or benefit a member or beneficiary will receive. The most clear cut example of this would be if a member were supposed to be contributing to the retirement system at a rate of 8 percent, but actually contributed at a rate of 9 percent until the mistake was discovered. The return of those excess contributions would have no effect on the member’s pension or benefits.

This was the subject of the Appeals Court case of *Hollstein v. CRAB*, 47 Mass. App. Ct. 109 (1999). Jeannie Hollstein and nine others were employees of the Boston School Committee. The City of Boston deducted excess contributions from these ten people. The excess contributions ranged from one to three percent from each member’s salary for a varying number of years, one for twenty-four years. When the City’s error was discovered, the Boston Retirement Board (“the Board”) corrected the contribution rates and refunded the excess contributions. The employees sued for interest on the refund. The Appeals Court decided that they were not entitled to interest.

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Among other things, the Appeals Court emphasized that the error had been made by the Boston School Committee and not the Board; that G.L. c. 32, § 11(1) provided for such a specific grant of interest and that if the drafters of G.L. c. 32 had wanted interest to be paid in other circumstances, that they would have specified it; and, perhaps most importantly, the plaintiffs would receive all the retirement benefits to which they were entitled.

Hollstein was not overruled by *Herrick*. In fact, it is not mentioned in the *Herrick* case at all, despite being briefed by one of the parties in the case. We must conclude, therefore, that *Hollstein* remains good law.

In accord with *Herrick*, a mistake made by a Board which results in a member or beneficiary receiving less than the benefits to which they would have been entitled will result in a retirement board paying the correction of errors interest rate to a member or beneficiary.

In accord with *Hollstein*, interest should not be provided to the member in a situation where a return of deductions is processed when the deductions were erroneously contributed. As noted above, *Hollstein* held that “Chapter 32 expressly authorizes an interest-bearing remedy only in instances in which the error of the board has affected the ‘benefits’ that retired members and beneficiaries actually [receive] from the board...” *Hollstein*, at 111. Interest should only be paid when an error is discovered that results in a change in the benefit amount paid to the member.

This was recently affirmed in a decision by the Division of Administrative Law Appeals (“DALA”) dated November 24, 2017, *Lydon v. Quincy Retirement Board*, CR-16-479. In *Lydon*, the member was refunded excess contributions, and asked for interest on the refund. The Quincy Retirement Board declined to pay interest. DALA affirmed the Board’s decision, relying on *Hollstein*, G.L. c. 32, § 20(5)(c)(2) and PERAC Memorandum No. 43/1999.

Amendment to PERAC Memorandum No. 29 of 2016

Given all of the above, Section 3, Paragraph C of Memorandum No. 29 of 2016 has been edited as follows:

C. Buybacks Previously Furnished for Uncompensated Service

Any payments made by members for uncompensated service under G. L. c. 32, § 4(2)(b) must be returned to the member pursuant to G.L. c. 32, § 20 (5)(c)(2) without interest in accordance with the Appeals Court’s decision in *Hollstein v. CRAB*, 47 Mass. App. Ct. 109 (1999.) ~~Supreme Judicial Court’s decision in *Herrick v. Essex Regional Ret. Bd.*, 465 Mass 801 (2013). Please see PERAC Memorandum #32/2013 for more information on the calculation of interest in this type of scenario.—~~

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Example:

~~*Assume that Retirement System A has a regulation whereby they use 3% interest rate for payments made pursuant to the Herrick decision for this example. A member made a payment to Retirement System A in the amount of \$1,200 on September 1, 2014 to receive credit for 5 years of call firefighter service. System A returns this amount to the member on January 1, 2017. System A would include no interest on this payment to the member. 2 years and 4 months on interest on this amount. Thus, System A would return \$1,285.81 to the member (the original \$1,200 plus interest of \$ 85.81). This amount is determined as follows: $\$1,200 \times 1.03 \times 1.03 \times 1.01 = \$1,285.81$. [Note: the interest rate to use for the 4 months is: $3\% \times 4 \text{ months} / 12 \text{ months} = .1\%$.]*~~

Note: The question of what a member should pay the retirement board in the reverse situation (the member paying back previously refunded Section 4(2)(b) payments) will be addressed in Section II.

SECTION II

A MEMBER OR BENEFICIARY PAYING INTEREST TO A RETIREMENT BOARD

As was just set out above, a Board must pay interest to a member or beneficiary when benefits have been underpaid. It naturally follows that a member or beneficiary will owe interest to a Board when an allowance has been overpaid.

In the usual case, it is clearly understood that a member or beneficiary buying time must do so with interest to “make the system whole.” This is true when purchasing prior non-membership time from the same board under G.L. c. 32, § 4(2)(c), when purchasing prior membership time with a different board under G.L. c. 32, 3(5), or when redepositing a refund under G.L. c. 32, § 3(8)(b). A question arises, however, in a situation in which no statutory provision is applicable: the establishment of credit for time when a member has been erroneously excluded from membership.

Members Erroneously Excluded from Membership:

PERAC has long advised that a person purchasing time for which they were erroneously excluded should do so without the payment of interest. An excerpt from PERAC Opinion Letter 10/101 is illustrative of PERAC’s longstanding position in such cases. This particular opinion letter involved six police officers who should have been made members of the system in January

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of 1983 but were not made members until April of 1983. In 2010, PERAC was asked if these six members should pay interest on their purchase of these three months of service. Assessing interest would have meant that the members pay interest for the 27 years between 1983 and 2010. PERAC instructed:

The Commission has opined that if an error in membership date or in the amount in a member's account is through no fault of the member, the member can purchase the applicable service and no interest will be charged to the member. In this case, the membership date delay was apparently as the result of an error by the payroll clerk. Because the members were not at fault and were without knowledge of the error, they cannot be penalized by being required to pay interest on the service purchase.

The DALA case of *Ronan Jacobson v. SBR & Salem*, CR-00-987 (9/7/2001) involved an individual excluded from membership because of the funding source of her job. DALA made the following finding of fact in that case:

16. In June 1999, the Public Employee Retirement Administration Commission (PERAC) provided information to the Salem Retirement Board "concerning whether interest must be charged when a member is buying back creditable service for C.E.T.A. employment." Noting that the source of the funding for the position is not determinative of whether there should have been membership in the C.E.T.A. position, PERAC instructed that if the member "is making this buyback because they were erroneously excluded from membership because the source of funding for the position was from a C.E.T.A. grant, then the member may purchase this creditable service without interest." PERAC further instructed that they "would also receive the contribution rate that was in effect at the time they should have been made a member of the system." But, if the employee was "excluded from membership because of other rules of the board unrelated to the funding for their position, the member would be required to pay interest on this buyback and would not be entitled to the contribution rate that was in effect when they began their employment."

PERAC's position in regard to individuals erroneously excluded from membership throughout the years has been consistent. DALA and CRAB had, until very recently, consistently upheld this reasoning. "Also, as instructed by PERAC in its June 30, 1999 letter...Ms. Ronan-Jacobson owes no interest in making her buyback payments to secure this creditable service." *Ronan-Jacobson*, supra. However, an Appeals Court case rendered in 2006 began to change the landscape in this area of the law.

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In *Bristol County Retirement Board v. CRAB*, 65 Mass. App. Ct. 443 (2006), which involved a person who had overearnings post-retirement, the Court declared that DALA and CRAB have no equitable powers. Earlier decisions of DALA and CRAB, which sought to “make things right,” had essentially been premised on the idea that those bodies had equitable jurisdiction. Decisions made on equitable grounds included the decisions rendered about interest not being due in the wake of erroneous exclusions.

The first decision which declared that interest needed to be paid on erroneous exclusions was *Knightly v. State Board of Retirement*, CR-10-15 (DALA decision January 14, 2011, no CRAB decision), which stated:

The Petitioner does not cite any provision in Chapter 32 for the proposition on which he bases this appeal, i.e. that it is "well settled" that "a member who was erroneously excluded from membership is entitled to purchase this past service rendered, interest free."

The *Knightly* decision was made after, and explicitly based upon, the *Bristol County Retirement Board* case.

The *Bristol County* decision involved the so-called “Needham Bill,” as found at G.L. c. 32, § 20(5)(c)(3). Inserted into Chapter 32 in 2000 by chapter 159 of the Acts of 2000, the Needham Bill makes it possible for a retirement board to waive amounts owed to it by members and beneficiaries provided that certain conditions are met. G.L. c. 32, § 20(5)(c)(3) is discussed more fully later in this memorandum. The Appeals Court correctly decided that CRAB cannot force a retirement board to provide a Needham Bill waiver, that is instead up to the discretion of the individual board.

In the fairly recent decision of *Marie McDonough v. Quincy Retirement Board*, CR-13-357 (DALA decision November 9, 2016, no CRAB decision), a DALA magistrate determined that the Petitioner must pay interest when establishing service credit, despite being wrongfully excluded from membership:

... An employee who buys back prior service is paying retirement deductions that would have been taken from her paycheck earlier, had she been eligible at the time. Interest represents the time value of money and puts the person paying late in the same position as the person who all along was having retirement deductions taken from her paycheck.

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Given these two cases, PERAC has had to revisit its long held position regarding the imposition of interest when a member establishes service credit in situations where he or she has been erroneously excluded from membership. It seems clear that CRAB has decided that interest must be attached to such payments. What is not clear is the rate of interest to be attached to such payments.

In *Knightly*, CRAB found that the member must pay “buy back” interest when he established his non-membership credit. However, *Knightly* was decided on January 14, 2011, prior to Chapter 176 of the Acts of 2011 being enacted, and prior to the decision of the SJC in *Herrick*.

McDonough was decided after Chapter 176 and after *Herrick*, although neither of them are mentioned in the decision. (Section 20(5)(c)(2) is discussed, in conjunction with the *Bristol County* decision.) In *McDonough*, the member in question had first been employed in 2008, and began contributing to an alternative plan, in this case ING. In 2010, she began to seek retirement system membership. Eventually, the retirement board made her a member in 2012, and she was permitted to buy back her time between 2009 and 2012. She went to CRAB over the sole issue of whether she should pay interest on this purchase. To put this in perspective, she owed \$8,028.01: \$7,568.78 constituted the payroll deductions that would have been made for this period, \$499.23 represented interest.

The *McDonough* decision finds that those erroneously excluded from membership would buy back the time under Section 3(3) as opposed to 4(2)(c). The decision also states that buy back interest will attach when purchasing time under either Section 3(3) or 4(2)(c). Importantly, the rate of interest to be paid was not the focal point of this decision. “The only dispute is whether she should have to pay interest on the amount the Quincy Retirement Board charged her.” (Emphasis supplied.) Because of changes in the statute brought about by Chapter 176, PERAC does not believe a buy back interest rate would attach in all such cases. In fact, were Section 3(3) to be utilized in regard to such purchases, actuarial assumed interest would have to attach to such payments.

However, *McDonough* acknowledges that “the retirement statute does not explicitly state how to handle cases in which an employee is wrongfully excluded from membership in a retirement system...” In *Hollstein*, it was found that since an interest rate wasn’t specifically provided for in the statute regarding the return of erroneously collected contributions, interest couldn’t attach to those payments. Here, CRAB acknowledges that the statute itself does not make provisions for erroneously excluded members. Although CRAB believes interest should attach, there is some confusion about which interest rate should apply. It is PERAC’s position that since these members have been excluded by an error, it is more logical for the “correction of errors” interest rate to attach to the payments of those erroneously excluded.

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The *McDonough* decision does not mention *Herrick*, supra. As noted in Section I, in accord with *Herrick*, when an error has been made which affects the amount of a benefit to which a member or beneficiary was entitled, payment is made under the “correction of errors” rate as adopted by each retirement board.

Finally, the fact that members are sometimes erroneously excluded reminds us that it is a best practice for the retirement staff to review payroll records on a regular basis.

Other Situations

Therefore, in other cases, for all purchases of rendered creditable service, whether a redeposit of a refund or a purchase of prior, non-membership time, a Board must require the member or beneficiary to pay interest. The member or beneficiary will then be entitled to all the time they would have been entitled to had they been paying into the system all along.

A member will purchase service, redeposit a refund, or buy back time under various subsections of G.L. c. 32, §§ 3 and 4. Each of the sections allowing for a buyback of time assigns a rate of interest.

Which Interest Rate is Payable?

A member or beneficiary making a payment which was prompted by the discovery of an error by the Board, including those who were erroneously excluded from membership, should pay under the correction of errors rate as adopted by each individual retirement board. As we noted in Memorandum No. 32/2013, “As the court in *Herrick* points out, these interest payments should be included in each instance where a retirement board utilizes G. L. c. 32, § 20(5)(c)(2) to make an adjustment, in addition to court-ordered adjustments.”

Otherwise, in general, the purchase of prior non-membership time under Section 4 will require buyback interest, the purchase of prior non-membership time under Section 3 will require actuarial assumed interest, and the redeposit of previously refunded time will require either the payment of buyback or actuarial assumed interest, depending upon the timing of the redeposit.

Section 4(2)(b) Refunds Payable to the Retirement Board

In Section I, we discussed the situation in which a retirement board may have to refund amounts paid under Section 4(2)(b) to the member. There will also be situations in which a member must return a Section 4(2)(b) refund he or she has received to the retirement board. If a member received any interest on that refund, the interest paid to the member must be returned to the retirement board.

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If a member is still in service, he or she may wish to enter into a payment plan with the retirement board involving deductions from his or her paycheck. If the member has already retired and still owes the retirement board this previously refunded money, he or she may either pay the retirement board what it is owed, or the retirement board could utilize the so-called "Vatalaro Formula" until the money owed to the retirement board has been recouped. This formula was first described in a CRAB decision entitled *Anthony Vatalaro v. State Retirement Board*, CR-9962 (March 16, 1987).

Members Who Have Paid Into the System All Along, but at the Incorrect Deduction Rate

In addition, a member should not pay interest on any under-withheld retirement deductions he or she may be required to remit to the Board. Since a Board will not have to pay interest to a member when refunding excess deductions (See Section I, supra), it naturally follows that a member will not have to pay interest to a Board when paying deductions which should have been taken at a higher rate, but were not. As DALA found in *Lydon*, "The Petitioner...incorrectly concludes that a member would be required to pay interest on any under-withheld retirement deductions. PERAC [Memorandum No. 43/1999] specifically excuses members from paying interest to correct under-withheld retirement deductions."

PERAC Memorandum No. 43/1999 was concerned with collecting contributions which had not been withheld on all amounts above \$30,000. The memo instructed that the contributions be collected, but without interest.

Waiving the Requirement of Interest

Interest may be waived under the so-called "Needham Bill" as discussed earlier in the memorandum.

Massachusetts General Laws Chapter 32, Section 20(5)(c)(3) vests discretionary authority in a Board to waive all or part of a payment a member or beneficiary may owe to the Board. It follows that a Board may relieve a member or beneficiary of his or her obligation to pay interest when an error has been made, but only in those situations where the criteria set out in that Section have been met:

- (i) the error in any benefit payment or amount contributed to the system persisted for a period in excess of one year;
- (ii) the error was not the result of erroneous information provided by the member or beneficiary; and

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(iii) the member or beneficiary did not have knowledge of the error or did not have reason to believe that the benefit amount or contribution rate was in error.

It must be emphasized, however, that, in accord with *Bristol County*, supra, a Board's decision to grant a waiver of this type is purely discretionary.

SECTION III

EXAMPLE CHART

Scenario	Interest is Paid	Interest is Not Paid	Comments
Payroll incorrectly withheld retirement deductions on overtime payments.		✓	This does not affect the benefit to which the member was entitled. The refund of the deductions will be without interest.
Member overpaid for a service purchase.		✓	This refund of money paid will not affect the amount of the benefit to which the member was entitled. Therefore, the money will be returned to the member without interest.
Retirement allowance calculation does not include stipend in a 3-year or 5-year average.	✓		This affects the benefits or amount of pension to which the member is entitled, so the correction of errors interest rate will attach to the retroactive payment.
Dependent Allowance not paid for four years after ADR is approved.	✓		Correction of errors interest rate would attach since this affects the amount of the allowance or benefit.
Person on Superannuation is approved for accidental disability retirement, and an adjustment must be made.		✓	This adjustment is payable without interest, as no error has been made by either the board or the member, no matter what the separate options were.
A member receives a retroactive contract settlement.		✓	There is no interest because there has been no error.

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Scenario	Interest is Paid	Interest is Not Paid	Comments
Member erroneously excluded from membership buying back excluded time.	✓		Member will pay the correction of errors interest rate which has been adopted by his or her retirement board.
Member paid amount Board calculated for service purchase, but this was later found to understate what should have been paid	✓		Member will pay the interest rate of the section the buyback was originally made under, either Section 3 or 4. Generally speaking, the purchase of service will always include an interest payment to the Board.
Payroll did not withhold retirement deductions on a stipend.		✓	When making up an underpayment of deductions, such a payment will always be made without interest.
Retirement allowance overpaid for a number of years.	✓		The repayment of the amount overpaid by the retirement board will include the correction of errors rate of interest. This affects the benefits or amount of pension to which a member is entitled.
Member making an overpayment under Section 91 or 91A to a retirement board.		✓	No interest is payable as it does not affect the amount of a benefit or pension.
Option B refund underpaid or overpaid.	✓		Correction of Errors Interest Rate is payable because an Option B refund would be considered a benefit
Member given a refund, but interest not paid at the correct rate. (He should have been paid 3% but his refund was calculated with regular interest instead.) The Board is paying him the difference in the interest three years later.		✓	No interest will be payable to him on this payment because this error does not affect the member's benefit.

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SECTION IV

APPLICABILITY AND CONCLUSION

Applicability of this Memorandum

The policies enunciated herein, including the amendment to the previous memorandum, shall be prospective from the date of this memorandum onward.

Conclusion

We trust the foregoing will be of some assistance to you. If you have any further questions or concerns about this, please call Deputy General Counsel Judith Corrigan at Extension 904.