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Testimony of the Boston Municipal Research Bureau

Before the

Joint Committee on Public Service

April 7, 2011

Regarding: Reform of the Massachusetts Pension System

My name is Samuel R. Tyler, President of the Boston Municipal Research Bureau, a business sponsored organization that provides objective analysis and data on policy issues in order to promote a more efficient, economical and responsible government for Boston. Since 2005, the Research Bureau has devoted much of its attention to the escalating cost of public employee spending, with particular emphasis on health insurance and pension expenditures.

We believe that it is very important for the Legislature to enact comprehensive change in the Massachusetts public pension system this year that will control long-term costs, improve management, further eliminate abuses and create a more equitable system for public employees. With this testimony, the Research Bureau is submitting recommendations for pension reform from our report on the Massachusetts retirement system issued in May 2010. We also endorse the Governor's bill (H00035) which is the most comprehensive bill before you and includes several recommendations that we share and other thoughtful measures. If enacted as filed, this bill is estimated to generate savings over $3 billion for the Commonwealth and $2 billion for municipalities over the next 30 years.

Given the financial and demographic trends facing the Commonwealth regarding the 105 state (2) and local (103) retirement systems, the recommendations made by the Research Bureau and in the Governor's bill should be considered the minimum base of what should be enacted. We believe that additional reform measures will be required in the future but that the recommendations presented are needed now. A few reasons why we believe taking steps to achieve comprehensive reform and long-term economic pension savings is important now include:

- As a result of the pension fund asset loss in 2008 and other factors, the Massachusetts State Employees' Retirement System (MSERS) unfunded pension liability increased from $2.4 billion in fiscal 2008 to $5.8 billion in fiscal 2010. The funded ratio decreased from 89.4% in fiscal 2008 to 76.5% in fiscal 2010.
- The increased pension liability due to asset losses contributed to the state's decision to extend the time to reach full funding by 15 years to 2040.
- As currently reported, pension liabilities may be understated. For example, the state assumes an 8.25% return on its pension investments which may need to be reduced in future years, further increasing the pension liability.

- Moody's Investors Service recently issued a report that ranked states based on their combined net tax-supported debt and pension liability figures to provide a more integrated view of states' total obligations. Of the 50 states, Massachusetts was one of four states identified with the largest combined debt and pension obligations.
- The Commonwealth and its municipalities face even larger personnel liabilities for retiree health insurance (OPEB) which will not be adequately addressed until the unfunded pension liability is closer to being fully funded.

Local Benefits of Pension Reform

For local retirement systems such as the State-Boston Retirement System (SBRS), comprehensive pension reform is needed to help manage its long-term financial requirements. Over the six years from fiscal 2005 to fiscal 2011, the City of Boston's pension appropriation increased by 53% while the total operational budget increased by 23%. Employee health insurance increased by 54% during this period. The pension number is net of teacher pensions and the one-time pension payment due to the teacher transfer issue. As a result of the 2008 asset loss, Boston's unfunded pension liability increased from $951.6 million to $1.4 billion and the funded ratio decreased from 77.4% to 69.9%. Boston's retiree health insurance liability as of June 30, 2009 was between $5.8 billion (partially funded) and $3.7 billion (fully funded) with both estimates being far in excess of the pension liability. Thus, pension reform is necessary to control the long-term growth of pension expenditures, to enable local retirement boards to reach full funding sooner which will allow the cities and towns to address the OPEB liability in a more timely and meaningful way.

Initial Steps for Pension Reform

Comprehensive pension reform to provide greater long-term financial stability for the Commonwealth and its cities and towns is overdue in Massachusetts. In 1987, Massachusetts approved legislation (Ch. 697, Acts of 1987) to enable retirement boards to fund pension liabilities actuarially and adopt funding schedules that would amortize unfunded liabilities over a 40-year period. No major change was made until 22 years later when in June 2009, the Governor and Legislature approved legislation (Ch. 21, Acts of 2009) which closed loopholes and reformed statutory provisions that caused the most egregious pension abuses among public employees and elected officials. This legislation was an important first step that will benefit the pension system, but it did not create the long-term financial benefit for each of the 105 Massachusetts retirement systems that will be required in the coming years.

In October 2009, the Pension Reform Commission chaired by Dr. Alicia Munnell, released its report that identified a series of action steps to improve the equity, efficiency and fiscal stability of the pension system. The work of this Commission has influenced subsequent reports and legislative proposals.

The Boston Municipal Research Bureau prepared a detailed analysis of the state pension system which was released by The Boston Foundation in May 2010 as part of its Understanding Boston, The Utility of Trouble series. The report, *Providing Pensions in Difficult Times: A Comprehensive Study of the Massachusetts Pension System and Its Impact on the City of Boston*, was written as a primer for understanding the workings of the state pension system and makes several recommendations to bring systemic reform in this era of limited resources.

The full report with recommendations is being submitted today and the key recommendations made include the following.

Main Recommendations

- **Prorate benefits by time spent in each employee group**. Rather than basing benefits on an employee's group at retirement, proration will provide a better representation of an employee's work history and remove an incentive for abuse.
- **Widen the salary averaging period**. Increase the salary averaging period from three to five years to provide a wider view of employee earnings and limit opportunities for manipulation.
- **Prevent spiking with limits to pensionable compensation increases**. For pension calculations, recognize only one-year increases in compensation up to 7% plus inflation for the two years before retirement.
- **Eliminate termination allowances**. Employees who are eligible for termination allowances (Section 10) are by definition eligible for a deferred retirement allowance when they turn 55 and do not need to receive an earlier enhanced benefit.
- **Require a higher standard for approving individual benefits legislatively.** More scrutiny should be required to pass special legislation that provides enhanced pension benefits to an employee. A PERAC-confirmed cost analysis and comment from the retirement board should be required.
- **Remove waivers on work restrictions for teachers**. Retired teachers should comply with the same earnings restrictions that apply to other public employees. Sensing a critical shortage of teachers due to high retirements, Retirement Plus enacted in 2001 provided for retired teachers to return to work in school districts without earnings and work restrictions but the retirements losses did not materialize.

Other Recommendations

Recommendations not made in the Research Bureau's report in 2010 but which we fully support include the following:

- **Increase retirement age factors**. Increase the age to reach the maximum pension benefit accrual rate (2.5%) from 65 to 67 in Group 1, 60 to 62 in Group 2 and from 55 to 57 for Group 4. Group 3 employees (State Police) receive full benefits under a different calculation that does not use benefit accrual rates. Extending the age for full pension benefits is being introduced in other states, the private sector and for Social Security benefits.
- **Increase eligible age for retirement**. Currently employees with at least 10 years of credible service in Group 1 are eligible to receive a retirement allowance at age 55. We support the Governor's proposal to increase the age to 60. For employees in Group 4, the retirement age should be increased from 45 to 50.

Further Study

The Research Bureau made two recommendations that we believe would require further study before a formal recommendation can be made. We also made a recommendation for implementation that the General Court might want to submit for additional study before acting on it. We note that the Governor has recommended the creation of a special commission to study one of the recommendations that we jointly make. We recommend that this special commission include two other issues in its study.

- **Update and standardize the group classification system.** Uncertainty over what positions fall into which employee group results in some employees receiving very different benefits than other employees with similar responsibilities depending on their retirement system's interpretation of their classification. The Research Bureau recommended a detailed review be undertaken of the group classification system that evaluates the need for each group and determines which positions should be classified in each group. The Governor's bill (H.00035) before this Committee calls for the creation of special commission of 11 members to study the Massachusetts public employees' group classification system. We concur.
- **Set employee and employer contributions as a share of normal cost for the employee's group.** A key inequity of the current pension system is the way future benefit costs are shared between the state or municipal employers and different employee groups. Under the current system, all employee contribution rates are set by the date of hire and are not linked to the benefit the employee is expected to receive depending on group classification. The state or municipal contribution to future benefit costs is simply the amount needed to fill the gap between the employee's contribution and the total normal cost calculated by the actuary. The result is that employees who make the same salary contributions based on percent of salary receive different benefits depending on which group they are assigned. Employees in Group 1 will fund all or essentially all of their own benefit through their own contributions and investment returns, while employees in higher groups, like public safety officers in group 4, receive higher benefits earlier and thus pay a smaller share of their pensions with the governmental unit paying a higher share. Basing employee pension costs on a percentage of normal costs (the pension cost incurred by an active employee in the current year that will be paid after retirement) is more equitable and allows increases in the benefit costs to be shared between employees and employers. This issue too requires further study and should be sent to the special commission for analysis.
- **Reform presumption laws for public safety.** Under existing Massachusetts laws, certain medical conditions are presumed to be job-related for public safety officers regardless of the specifics of an individual's case, thus making them eligible for accidental disability retirement benefits. A study should be initiated to determine whether advances in medical research can enable the current presumption language to be more narrowly defined regarding medical conditions specifically tied to the work environment.

Conclusion -

The case is compelling for the importance to Massachusetts and its cities and towns that the Legislature approve comprehensive pension reform this year that will control long-term costs, improve management, further eliminate abuses and create a more equitable system for public employees. Pension reform is overdue with the first important step in 22 years taken by the Legislature in 2009 to address the most egregious abuses. Now the matter of long-term cost control needs to be addressed. The Governor's bill (H00035) provides the framework for this legislation which is the base minimum of what should be enacted. The creation of a special commission to study the group classification system should be approved with two other issues recommended by the Research Bureau included in the study.