

# Just the Facts

## Pending Pension Legislation

The Legislature is expected to consider changes to the pension system this fall that would affect future public employees. Today, public employees pay the vast majority of their own pension costs in Massachusetts. The pension system is a good deal for the taxpayers. There is no justification for cutting future employees' pension benefits.

The Public Service committee held a hearing on the governor's bill, House 35, on April 7 and the Senate passed its version of the bill, Senate 2018, on September 15. It is likely the House will consider its version of the bill this fall. House 35 seeks to reduce the state's contribution to the pension system by \$5 billion over 30 years. If passed, it would change the retirement system for future employees by:

- 🔍 Reducing benefits.
- 🔍 Requiring future employees to work an additional five years before being eligible to retire.
- 🔍 Requiring future employees to work longer to reach their maximum pension levels.

The Legislature has already passed two pension reform bills that focused on stopping people from gaming the system. This new pension bill is unwarranted and should be opposed.

### **IS THE CURRENT PENSION SYSTEM A GOOD DEAL FOR THE COMMONWEALTH?**

**YES!** In 2010, the state saved over \$370 million by funding its own pension system and not participating in Social Security.

The Commonwealth's pension contributions are among the lowest in the nation among non-Social Security states, and the Massachusetts Teachers' Retirement System has the lowest cost of any state.

States that participate in Social Security pay 6.2 percent of payroll into that system, in addition to making contributions toward employee pensions. Massachusetts contributes less than 3 percent of payroll for all public employee pensions and less than 1 percent of payroll for new teachers.

### **HISTORY OF MASSACHUSETTS PENSION SYSTEMS**

The Massachusetts state retirement system was established in 1911 and provides a defined benefit to public employees. Today virtually all public employees participate in one of the 106 contributory retirement systems for public employees in the Commonwealth – and they do not participate in Social Security.

### **EMPLOYEE CONTRIBUTION RATES – TEACHERS AND OTHER GROUP 1 EMPLOYEES**

Since 1996, newly hired "Group 1" employees have contributed 9 percent of their first \$30,000 in salaries and 11 percent of all additional salary. Beginning in 2001, all new teachers were enrolled in "RetirementPlus," which requires them to contribute 11 percent of their entire incomes to the pension system.

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These employees will fund the vast majority of their pensions through their contributions and the interest earned. Teachers hired today can expect to fund 95 percent of the value of their own pensions.

#### **WHAT IS UNFUNDED PENSION LIABILITY?**

Prior to 1983, the state funded the pension system on a “pay-as-you-go” basis. It did not adopt a funding schedule until the early 1990s. In addition, the state has sometimes failed to live up to its pledges to provide adequate funding for the system. In 2003, for example, then-Governor Mitt Romney promised to transfer \$145 million from the sale of state assets into the system, but he failed to do so. By failing to put money aside to address its future pension obligations, the state is facing an unfunded pension liability of \$20 billion for state employees and educators.

Fortunately, the state has adopted a funding schedule that will pay off this unfunded liability by 2040 at the latest. Once that obligation is retired, the state’s pension costs will drop dramatically.

#### **DOES THE PENSION SYSTEM NEED TO BE CHANGED TO ADDRESS UNFUNDED LIABILITY?**

New employees entering the system have nothing to do with the unfunded liability. This liability has nothing to do with the benefits they receive, and their pensions should not be affected by the unfunded liability.

#### **BOND RATING VS. UNFUNDED LIABILITY**

According to many experts, pension funding does not have a statistically significant effect on bond ratings, especially now that the state has adopted an amortization schedule. The bond rating is strongly affected by the overall fiscal management of the state, which includes raising adequate revenues to fund needed services and maintaining the rainy day fund.

#### **8.25 PERCENT – AVERAGE ANNUAL RATE OF RETURN**

Currently public employee pensions assume an annual rate of return of 8.25 percent. Some have contended that this is too high and that we need to reduce benefits just to be safe. The Public Employee Retirement Administration Commission – PERAC – has suggested that over time, an investment return assumption of between 7 percent and 7.75 percent may become the standard. At present there is no discussion of adjusting the figure. This is likely so because that would be paid for by the state, while decreasing the value of a pension is paid for by the employee.

#### **CONCLUSION**

Teachers, higher education staff, education support professionals and other Group 1 employees fund the vast majority of their pensions, with new teachers paying 95 percent of the costs. Efforts to reduce the value of public employee pensions should be rejected. In fact, the change that is most needed in the pension system is to improve the cost-of-living adjustment for current and future retirees. The COLA is limited to \$360 a year, which is not nearly enough to keep up with the actual increase in the cost of living.