

**RETIREMENT SYSTEMS FOR
PUBLIC EMPLOYEES**

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Retirement Systems for Public Employees

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Chapter 8

Administration

THE ADMINISTRATIVE structure of a public employee retirement system is usually headed by a retirement board or a chief officer, whose primary function is the overall direction of the system within the bounds prescribed by the system's controlling statute. In a large system the board employs an executive director, who in turn hires necessary staff assistance. In addition to full-time staff, which may include persons having specialized technical skills, some part-time help of a professional nature is generally needed. The functions carried out by this administrative organization are described in this chapter.

RETIREMENT BOARD

Nearly all public employee retirement systems place the ultimate responsibility for administration in a governing board. The duties of the board range from making fundamental policy decisions to handling minute administrative details. Policy-making responsibilities include selection of top staff personnel, setting of basic investment goals, review and approval of budgets for administrative expenses and payroll,

and establishment of regulations governing benefit determinations within the broad scope of the law. The extent to which the board moves beyond policy-making decisions into the execution and administration of this policy depends upon the size of the system and its supporting staff, and the traditional and political environment within which the system operates. The board of a small system without a paid staff carries out its own decisions. The board of a larger system, while divesting itself of many details, may retain direct responsibility in the more sensitive areas which might otherwise be passed along to staff. Examples of the responsibilities often retained are the authorization of specific investments, and review and approval of disability claims. These are areas having substantial importance for financial or political reasons, or because of their effect on public or personnel relations.

A board's sensitivity to influences of the sort just mentioned is affected by the method used to choose its members. The employees covered by the system are often represented by one or more board members. Such a member may be appointed by the governor or by some other elected official, or he may be elected by the employees themselves. Other members of the board generally represent the employer or employers. Employer representation is commonly *ex officio*: the attorney general, the superintendent of schools, the city clerk, and so forth. In some systems representatives of the general public are also included on the board.

Automatic appointment of officials to retirement boards has occasionally drawn criticism.¹ The objection raised is that the *ex officio* member of the board does not necessarily have the background, qualifications, or, for that matter, interest, to serve well on the board. The validity of this objection must be assessed in each individual case.

In a few large systems, the most notable example being the

¹ For example: "Ex officio representation of elected officials is not recommended for a retirement board. It has numerous weaknesses and generally few advantages." *Accounting and Operating Handbook for Public Employee Retirement Systems* (Chicago, Ill.: Municipal Finance Officers Association, 1966).

New York State Employees' Retirement System, a single person has the responsibility normally vested with a board. In New York that person is the state comptroller. Similar officials have corresponding functions in Delaware and Florida.

Some observers believe that the next several years will bring a change in the composition of a number of retirement boards, especially those of the larger systems in the United States. This change is expected to follow the pattern which has emerged in the area of negotiated pension plans in the private sector, to a large extent because of federal legislation. As collective bargaining in public employment becomes more prevalent, it is expected there will evolve a more formal recognition of employer and employee members of the board as such. They will tend to be distributed equally on each board and expected to act, at least to some extent, as spokesmen for their respective interests. If this change occurs generally, it will bring mixed blessings. It may help to assure employees of adequate attention to their interests at an administrative level. It may also help to define more clearly any issues separating the two parties and perhaps lead more easily to solutions. On the other hand, factional division of a board is likely to slow down its deliberations and lead to separate viewpoints on many questions, regardless of the importance of the question to the respective parties. Board members may place their responsibilities to their interests above their responsibilities to the well-being of the system itself.

ADMINISTRATIVE STAFF

A major responsibility of the board is the appointment of the director or executive secretary of the system. In theory, the responsibilities and courses of action of the person so appointed flow from the board. In practice, the director (by whatever title he goes) not only carries out the precepts handed down by the board, including being its emissary to the legislative body and to the employee groups, but also

provides substantial guidance to the board. The board often looks to its director for reactions to legislative proposals, for suggested changes in investment policy, and for guidance through the tortuous ravelments involved in the financing of the system. The director may be acquainted with the national trends in public retirement programs through his attendance at meetings discussing these trends. He generally receives the reports made by the technical advisors (such as the actuary, investment counsel, auditor, lawyer, and medical director). Since he usually is the board's spokesman to the legislature, he is also the target upon whom the lobbyists converge when changes in the law are contemplated. Often his most important attribute will be the ability to apprise his board of trends, both local, as expressed to him by the various interest groups, and national, where activities in a few systems may be the bellwether of future local changes. If he is unable to convince his board of the advisability of a particular course of action he prefers (for example, on legislation for benefit improvements), he must be able to represent his board's stand in discussions with other parties, despite his personal preferences.

The director of a small system may serve only part-time, acting as director because of responsibilities in another area (such as city clerk or personnel director). The director of a large system will have a staff and be responsible for its selection. He will often delegate a large portion of his day-to-day administrative responsibilities to an assistant in order to better carry out the functions described in the previous paragraph.

TECHNICAL STAFF

A retirement system needs technical expertise of a specialized nature. Of the various specialties, the actuarial is probably the least understood, because of its relatively infrequent application in other fields.

Actuarial. If the example used in the introduction to Chapter 6 may be called upon again, the actuary is the

hydraulics engineer who compares the flow of funds into the fiscal reservoir with the anticipated outflow to pensioners. The skill which sets him apart from the accountant, for example, is the application of probabilities involving life contingencies to the financing of the system. The actuary's tools must be sufficient to handle the complicated benefit structure and financing arrangements which typify retirement systems today. He must also be able to express the results of his estimates of financing needs in a manner that can be understood by the system's staff and board. It is doubly important that the actuary be understood because he needs feedback from the staff, both in checking the appropriateness of the assumptions he regularly uses as to future experience and in making estimates of the effect on these assumptions of potential changes in benefits or employment characteristics. Another duty the actuary is often called upon to perform is the calculation or verification of the amount of benefits payable to individual retirees. Finally, because a great portion of the actuary's experience is in the field of retirement programs, he often advises in the general areas of benefit design, planning and administrative procedures, in addition to the technical areas which are his specialty.

Accounting. Retirement systems also require technical help in the field of accounting. The accountant provides the board and other staff members, including the actuary, with financial statistics regarding the fund's investments. The accountant is generally responsible for establishing and updating the method of maintaining records of each participant's contributions and of those of the employer on his behalf. A computerized processing system is often used for this purpose in large systems. Such a system requires proper accounting controls to minimize errors, particularly where a number of agencies and political subdivisions participate. The processing system usually handles the collection of member and employer contributions from the various agencies, which sometimes number in the hundreds. An efficient method of processing accounts receivable improves the interest earnings of the retirement system by facilitating prompt collections.

The accountant for a public employee retirement system often must work within the framework of accounting practices established for other state, provincial, or municipal purposes. Improvements in accounting practices can be impeded or prohibited by legislative restraints. While these restraints have the basic purpose of protecting the taxpayer from misuse of public funds, they may also impose severe obstacles in the way of efficient practice, particularly because of the distinctive characteristics of retirement systems.

A problem faced by accountants for all pension plans, public and private, is that the largest liability on the balance sheet is the value of future pensions to participants and their beneficiaries. This liability cannot be inventoried without actuarial assistance and is subject to gains and losses which do not fit into conventional bookkeeping niches. Of a similar nature is the basic problem of determining the current costs associated with the financing of a pension plan. This has been the source of controversy for many years, but a 1966 opinion of the Accounting Principles Board of the American Institute of Certified Public Accountants produced a standard against which accounting methods can now be compared.²

Legal. Competent legal assistance is a necessity for a public employee retirement system, as it is for essentially all endeavors. A specific need which must be met by legal counsel is the drafting of proposed legislation when the provisions governing a system are to be amended. The lawyer reviews the proposals, studies the relationships between the proposals and existing statutes and judicial rulings, and drafts language to encompass the suggested changes. He will often be called upon to explain these changes to all interested parties and modify the language where necessary to accommodate various points of view. He may also be asked to discuss the legislation with committees of the legislature and to review amendments which may be imposed during consideration of a bill embodying the legislation.

Even where the utmost care has been taken in drafting the

² See footnote 1 to Chapter 5, p. 79.

language of the laws governing the retirement system, subsequent interpretation requiring further legal help may be necessary. This is even more likely when, as is not uncommon with small systems, the provisions of some of the bills affecting a retirement system are not subject to careful legal scrutiny before enactment. In general terms, the system's lawyer must counsel the staff and board as to their responsibilities under the law. Since their actions can result in changes in benefits to participants or in other decisions which might result in law suits being brought against the system's board or staff, they need legal advice of the highest caliber.

Medical. The responsibilities of the medical advisor to a system are similar in importance to those of other technical members, but narrower in scope. The medical advisor will often be called upon to aid the system's board or staff in judgments regarding the disablement of members. He must be able to translate the technical problems of his profession, including communications with other practitioners, into language the board can understand and use.

Investment. Another type of technical advisor needed by public employee retirement systems is the professional investment counselor. The scope of his duties and his importance to the system are discussed in Chapter 7.

Outside Professional Help. In small public employee retirement systems, practical necessity dictates that all of the professional counsel be given by consultants. Larger systems may employ full-time actuaries, accountants or investment managers. A large system may still use consultants in some of these fields, either solely or to supplement its own staff. To some extent, this is done to add the knowledge and experience of the consultant to the comparable skills of the system's staff. The use of a consultant also helps to counteract the natural tendency of staff technical advisors to perpetuate existing practices for reasons of tradition and limited viewpoint. Independence is another favorable attribute of a consultant, perhaps his most important. He may perform an audit and give his report directly to the board, to give it

assurance that the system's staff is properly carrying out its duties. An accounting audit is often provided through the auspices of a state or provincial auditor. Even where this occurs, an independent audit by a private accountant may be advisable, either on a regular basis or sporadically.

A somewhat different form of audit occurs in some jurisdictions where a watchdog pension commission is in existence. Such a "super-agency" might have its own staff, or employ separate consultants to analyze the reports of the retirement systems in its area. Although such a commission's audit is generally not carried out with the same degree of detail as one performed by an auditor specifically hired by the system itself, a pension commission review often puts into focus the major issues affecting public employee retirement systems. These issues include long-term financing goals, comparative investment practices, and the degree and type of uniformity of actuarial studies to be required of all the systems. This type of review can be valuable both to the general public and to the board of each system reviewed.

ADMINISTRATIVE EXPENSES

Expenses of administration are often insignificant in small public employee retirement systems. No salaries are paid directly by the system and the services provided for the system by personnel of the governmental unit may not be charged to the system by the unit. Thus the expenses for which the system is responsible may be limited to those for outside professional help and for such direct costs as bank charges and printing. These expenses would be paid either from the benefit funds of the system itself or directly by the city or other political entity controlling the system.

In larger systems, expenses are often under direct legislative control, as are the expenses of other agencies of the government. Sometimes an expense fund is developed from specifically allocated employer contributions. Occasionally the employers and participants contribute jointly to such a

fund. The allocation of money from this fund for specific purposes is often subject to appropriation by the legislature as part of its budgeting process.

A number of systems meet administrative expenses out of interest earnings, in one manner or another. The interest earnings so used are those that are in excess of those required for actuarial purposes. This technique allocates administrative expenses reasonably equitably between the participants and the employers, especially where interest is credited on employee funds separately. However, in comparing a system allocating its expenses in this way with another system, care must be taken to avoid a misstatement of either the true expense costs or the true investment earnings rate. Current administrative expenses should not affect actuarial assumptions as to future rates of earnings. Similarly, except for investment counsel fees and other direct investment expenses, administrative expenses are relatively independent of fund size and earnings rate. Administrative expenses in a system with a relatively stable membership but with rapidly growing funds constitute a larger percentage of investment earnings currently than they will in the future when the fund reaches a more mature size.

BENEFITS TO PARTICIPANTS AND THEIR BENEFICIARIES

Participants are required to make regular contributions in most systems. If a participant's service is terminated, his contributions are generally returned to him, usually with interest. The rate of interest to be paid is either specified in the benefit provisions or determined by the system's investment experience. In the latter instance, the board usually has the specific responsibility for setting the rate of interest to be credited. The board thus needs accurate predictions of the investment earnings to be received until its next opportunity to review the interest crediting rate. The board must also take into account other demands upon the investment earn-

ings of the system, particularly as they affect the actuary's determinations.

The mechanical procedures for crediting interest to each participant's account should be designed for clerical simplicity. For this reason, interest may be credited infrequently, often annually. As the use of electronic data processing equipment has become more common for this purpose, the larger systems have begun crediting interest more frequently, sometimes as often as monthly. Personnel relations are improved by this treatment because of its similarity to the more familiar treatment afforded by savings institutions. The frequent crediting of interest is at the opposite extreme from some systems' practice of not only crediting no interest in the early years of service but even confiscating some of the employee's contributions upon terminations.

In a few systems a member can borrow all or a portion of his accumulated contributions from the system. Administration of this type of arrangement can be quite difficult because of varying amounts borrowed, odd dates of borrowing, and provisions for periodic repayment of loans. The importance of the loan privilege is pointed up by the fact that new money loaned in a recent year to members of the New York State Employees' Retirement System amounted to over \$40 million as compared with retirement allowances paid of somewhat less than \$70 million.

The primary benefits administered by the staff of a public employee retirement system are retirement allowances. These are paid to participants who qualify because of age, service or disability, or to beneficiaries who qualify because of participants' deaths. For each benefit granted, the staff of a system must verify that the eligibility requirements are met and determine the benefit amount. This calculation is often made or reviewed by the actuary.

Payment of disability benefits imposes special demands upon an administrative staff. In many cases, the requirements for disability retirement make a clear-cut determination difficult. Moreover, periodic reviews must be made of claims that

have been granted, often with an examination of each pensioner's physical condition. Many systems also provide that any workmen's compensation benefits payable are offset against the system's disability benefits, necessitating review of workmen's compensation awards. This task may be made more difficult by the commutation of such awards to single amounts, or by compromise settlements, or by other irregular payments necessitating special administrative treatment.

OTHER ADMINISTRATIVE RESPONSIBILITIES

A substantial amount of a system's staff time may be devoted to questions about persons or groups qualifying to participate in the system. For example, most systems limit participation to those meeting certain requirements as to permanence of employment. Covered positions must be either full-time or part-time with at least a specified number of hours per week or per month. Difficult interpretations requiring judgment decisions may arise because of seasonal work or because of work patterns which, although unpredictable, are close to the requirements of the system.

Many systems require a waiting period for membership, often six months or a year. The waiting period is designed to eliminate from membership the short service employee who is generally subject to a high rate of turnover. Elimination of short-term employees reduces the number of employee records that must be set up and terminated. Despite this advantage, the waiting period is not necessarily helpful administratively, particularly if data processing equipment is used. Large systems covering a number of agencies often must set up records for all employees, even for those who have not met the eligibility requirements for membership.

The records are necessary to determine the proper waiting period of an employee who has worked for more than one employer. The system may also want to remind the employer when each employee's waiting period is completed. Both of

these administrative functions could be eliminated if there were no waiting period.

The administrative staff is responsible for reports submitted to federal offices for statistical purposes, to various state agencies for budgetary and informational uses, to the legislature and legislative bodies such as pension commissions, to the employers, and to the participants. Reports to employers and participants may be for the general purpose of recording the activities and progress of the system, or they may be to provide data relative to the specific employer or participant.

One staff function attaining increasing prominence in some systems is preretirement counseling. Where this service is provided, the primary responsibility of the counselor is to help each participant approaching retirement clearly understand the benefits he will obtain at retirement and the options available to him. In some systems, a significant portion of the time of the staff members having this responsibility may be devoted to matters not directly related to the system's operations. This may include review of a participant's overall financial status, suggestion of part-time activities and avocations, general discussion of medical and tax questions, and consideration of housing and travel plans after retirement. Extension of the counseling function in this way may be justified on the grounds that questions in these areas flow naturally from answers to basic questions about the system's retirement benefits.

Moreover, although some employers in a multiemployer retirement system might wish to provide this service themselves, instead of relegating it to the system's counselors, few employers have the skilled personnel with the special talents of communication required in dealing with older participants. Many employers have little interest in this aspect of their personnel relations. However it occurs, the provision of some form of general preretirement counseling is widely recognized as a means of aiding the retiree in adjusting to his new style of life.