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The Massachusetts Retirement Credit Bonus Legislation:

Missing the Mark While Costing Billions

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Introduction

Two bills before the Massachusetts legislature would increase the value of pension benefits for many state and local government employees. H.2808 was filed by Representative Jonathan D. Zlotnik and Senator (formerly Representative) John C. Velis.[1] An identical Act, S.1669, was filed by Senator Nick Collins.[2]

H.2808 and S.1669 (together "the Acts") would create a special retirement credit bonus for Massachusetts public sector employees who were required to or volunteered to work outside their homes between March 10, 2020 and December 31, 2020. The retirement credit bonus would add three years to the creditable service or age of an eligible employee for the purposes of computing their pension benefits. Eligibility is extremely broad. The retirement credit bonus would be available to employees of the Commonwealth of Massachusetts and its political subdivisions, including cities and towns, counties, community colleges, state universities, and all other public units in the Commonwealth.

The analysis in this brief primarily addresses the Massachusetts State Employees' Retirement System (SERS). However, as most public pension funds in Massachusetts have a similar structure, problems that arise with the use of a retirement credit bonus like that contemplated in the Acts would also arise in plans for teachers, local employees, and employees of other public sector entities in Massachusetts.

This brief has four primary findings.

The value of the additional pension benefits for a typical SERS member from the retirement credit bonus is just over $55,000.

Large benefit and broad eligibility

The first is that the increase in lifetime pension benefits for the average SERS member is very large. The value of the additional pension benefits for a typical SERS member from the retirement credit bonus is just over $55,000, or roughly 74 percent of the average state employee's annual salary. The dollar value of the retirement credit bonus is several times larger than bonuses awarded to essential workers in other states and localities during the pandemic. Given the broad applicability and low eligibility requirements in the Acts, enactment could increase the pension obligations of SERS by well over $1 billion. The Acts also apply to teachers and local plans. When plans other than SERS are included, the Acts would likely increase total Massachusetts public sector pension liabilities by several billion dollars.

Because the Acts do not provide supplemental funding these additional pension obligations would have to be met through increased contributions from plan sponsors, higher contributions from public employees, or both. Increased contributions from plan sponsors would require the diversion of revenue from other public purposes or increased levies on state and local taxpayers to fund benefits. Higher contribution rates from employees would reduce the take-home pay of public sector workers in Massachusetts.[3]

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Benefits more tied to compensation and years of service than exposure to the virus.

The second is that the retirement credit bonus is a diffuse means of rewarding employees for additional hardships experienced during COVID-19. The Acts do not differentiate among eligible employees by the severity of potential or actual exposure to COVID-19 on the job, by the type or importance of the work performed, or the amount of time a worker was performing tasks that involved increased risk of exposure. The primary factors that determine the value of the retirement credit bonus are the employee's compensation, years of service and age at retirement. As a result, the value of the retirement credit bonus is larger for employees in highly-paid positions with minimal exposure to COVID than for employees in lower-paid positions who performed critical tasks with a high level of exposure to the virus.

Program is ineffective as a past or future incentive

The third finding is that the retirement credit bonus program did nothing to incentivize workers to assume additional or hazardous duties in 2020 and is likely to do little to incent workers to do so going forward. The retirement bonus is purely retrospective as the Acts were filed after the eligibility period ended.

As a result, the value of the retirement credit bonus is larger for employees in highly-paid positions with minimal exposure to COVID than for employees in lower-paid positions who performed critical tasks with a high level of exposure to the virus.

Bonus programs can incent workers to exert greater effort or assume additional risks going forward if an employer has a prior pattern of providing rewards to employees that assumed hazardous duties. For this reason, cash bonus and premium pay arrangements can provide an incentive up-front if the employer has established a pattern of providing such benefits afterward.

In the case of the retirement credit bonus, the cost is so large (several billion dollars) and the benefits so poorly targeted that it is unlikely that a retirement bonus like that specified in the Acts would be provided in the future. Should policy makers wish to reward employees for service during the pandemic in a manner that would incentivize future participation, it would be more effective to do so with a bonus plan that is targeted and of reasonable cost so that it is repeatable in later emergency situations. A plan of this sort would establish baseline expectations regarding the manner in which public sector employers will reward workers who assume hazardous duties going forward.

The Acts only require that an employee have volunteered for duties outside of the home, not that these duties actually be performed.

Vague eligibility standards invite abuse

The fourth finding concerns the vague standards in the Acts for determining eligibility for the valuable pension enhancements. The Acts only require that an employee have volunteered for duties outside of the home, not that these duties actually be performed. The Acts also do not specify how much time between March 10, 2020 and December 31, 2020 that a worker needed to be performing tasks that involved heightened exposure to COVID. Moreover, in many instances record keeping of offers of service or the location of work performed may be poor as the pandemic arose suddenly and employers at the time could not have been aware of the eligibility standards specified in the Acts.

Unclear standards for determining eligibility increase the likelihood of fraud or abuse by employees seeking access to benefits afforded by the retirement credit bonus. The absence of clear eligibility standards will increase administrative and litigation costs for public employers and retirement boards.

Given the potentially large increase in pension costs associated with the Acts, the Public Employee Retirement Administration Commission (PERAC) and local government retirement boards should conduct full actuarial valuations of the impact of the retirement credit bonus on pension costs. These analyses should also address the source and amount of additional future pension contributions necessary to fully fund the additional obligations due to the retirement credit bonus. Results should be made available to the Legislature and the public before any action is taken on the Acts.

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The need to inform legislators and the public of the cost of the Acts is more pressing given that the Acts have attracted significant legislative support. As of October 5, 2021, 113 of the 160 members of the Massachusetts House of Representatives and 17 of the 40 members of the Massachusetts State Senate are sponsors or cosponsors of either H.2808, S.1669, or both.[4] The substantial number of cosponsors suggests that the Acts have a high likelihood of enactment, despite the fact that legislative support came without even an estimate of what the bills would cost. It would be fiscally irresponsible to proceed further without this data.

The increased cost of the retirement credit bonus to the Commonwealth and local governments must be considered in light of the current state of pension funding in Massachusetts. Many Massachusetts public pension systems are poorly funded.[5] A common measure to determine funding adequacy of public employee pension plans is the ratio of the value of the plans' assets to the actuarial value of plan liabilities (the "funded ratio"). The higher the funded ratio, the greater the likelihood that the plan will meet its obligations to retirees, which in turn translates to lower costs of funding retiree benefits for taxpayers, and lower future contributions required from plan members.

In 2020, the average U.S. public sector pension plan had a funded ratio of 75 percent.[6] In contrast, the State Employees' Retirement System was 67 percent funded at the beginning of 2021.[7] The Massachusetts Teachers' Retirement System had a funded ratio of 52 percent in 2019.[8] Many local pension plans have an even lower funded ratio. The Springfield Retirement System had a

29 percent funded ratio at the beginning of 2020.[9] At the beginning of this year the Fall River Retirement System was just 42 percent funded.[10] The retirement credit bonus would increase pension liabilities at a time when many state and local pension funds are in a precarious position.

The Massachusetts Teachers' Retirement System had a funded ratio of 52 percent in 2019.[8] Many local pension plans have an even lower funded ratio.

The Retirement Credit Bonus Versus Typical Bonus Plans

Cash bonus payments and premium pay are frequently used by government entities to encourage employees to take hazardous assignments or to ensure that critical functions are performed during a state of emergency. Such payments are akin to the use of combat pay by the military during wartime. Bonus payments are typically cash awards conditioned on performance of certain duties during a given period and are paid soon after those duties are performed. Premium pay is an increase in wages for employees who perform essential duties, or experience greater hazards in the performance of those duties. Premium pay is typically added to an employee's regular wage payments.

Bonus payments and premium pay have been used by state and local governments to reward employees who were required or volunteered to work in situations that involved increased risk of exposure to the COVID virus. The American Action Forum examined instances in which state and local governments provided cash bonus payments or premium pay to employees.[11] State and local governments in at least 35 states instituted hazard pay arrangements. Of the arrangements surveyed, the largest one-time cash bonus amount was $5,000, and for arrangements that provided premium pay on an hourly basis, the highest was $10 per hour.

Massachusetts has made use of cash bonuses and premium pay to reward certain state workers whose job assignments involved potential exposure to the COVID-19 virus. The Massachusetts Legislature set aside a reserve of $93 million in the supplemental budget for fiscal year 2020 for incentive pay at facilities that are open 24 hours a day including health care facilities.[12] Details on the use of hazard pay for some Massachusetts state employees are available. Full-time corrections officers who are members of the Massachusetts Correction Officers Federated Union who were not given the option of working remotely or on a hybrid schedule between November 2, 2020 and May 29, 2021 received $2,000 bonuses.[13] Those officers who worked part-time or on a hybrid schedule were given $1,000. Workers in state hospitals, mental health facilities, group homes, and social workers who were members of AFSCME Local 93 received temporary pay increases of $5-to-$10 per hour during the pandemic.[14] An additional $500 bonus was awarded to workers who did not miss a shift.

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The retirement credit bonus considered in the Acts differs from typical hazard pay arrangements. Hazard pay plans typically link the amount received by the employee to the amount and type of work performed during emergency situations. The linkage between the amount of work performed and the reward is most clear in premium pay arrangements where additional earnings are tied to the number of hours, weeks or pay periods an employee serves in a hazardous duty position. In contrast, the retirement credit bonus as specified in the Acts sets no minimum number of hours or weeks that an employee had to work outside the home to become eligible. Indeed, the Acts suggest that eligibility is triggered merely by volunteering to work outside of home.

Another difference is that additional earnings from performance pay and cash bonus systems are typically tied to the type of work performed during an emergency. This occurs because cash bonus payments are made soon after work is performed. In contrast, the value to the employee of the retirement credit bonus depends on the number of years of service and earnings throughout one's career in the Massachusetts public sector. Public sector workers may have several different jobs in the course of their careers and their final or highest earning years may be in positions significantly different from the roles they served in during the pandemic. In addition, retirement benefits also depend on variables such as age and tenure in the public sector. As a result, the value of the retirement credit bonus as specified by the Acts is divorced from the value of the work performed during the pandemic.

For SERS members, retirement allowances are based on the following formula:

First, the employee's average annual rate of regular compensation prior to retirement is taken into consideration. The method for determining the rate of regular compensation for purposes of computing retirement allowances differs depending on the date that an individual first became a SERS member. For individuals who became SERS members before April 2, 2012, the average annual rate of regular compensation is based on the employee's three highest earning years. For those who became SERS members on or after that date, the average annual rate of regular compensation is based on earnings during the member's final five years in state service.

Second, the number of years of creditable service an employee has accrued and the employee's age at the time of retirement are taken into consideration.

Third, the group to which an employee belongs is also taken into account when determining pension allowance. Massachusetts state employees are classified into four primary groups for purposes of computing pension benefits with the minimum age to receive a pension varying by group.

Finally, a percentage is derived based on age, years of creditable service, and group code. This percentage is then multiplied by the retiree's average annual rate of regular compensation prior to retirement to determine the initial annual retirement allowance. The Act would allow eligible employees to add three years to either their age at retirement or years of service for the purposes of computing their retirement allowance.

A similar approach is used to compute retirement allowances for teachers and local government employees. Because average annual earnings are based on the highest three or last five years, the earnings used to calculate retirement benefits for employees who switch careers may not be indicative of the type of work performed during the pandemic. Moreover, nowhere in the above formula is there any differentiation in terms of the hazards assumed during the pandemic. As discussed below, this may lead to situations in which the value of the retirement credit bonus for highly-paid workers with relatively modest exposure to COVID is several times higher than that received by lower-paid front-line workers.

In contrast, the retirement credit bonus as specified in the Acts sets no minimum number of hours or weeks that an employee had to work outside the home to become eligible. Indeed, the Acts suggest that eligibility is triggered merely by volunteering to work outside of home.

Size of the Bonus and its Cost to Pension Funds

This section considers the effect of the Acts on the pension wealth of the average active SERS member. Pension wealth is the present value of an individual's future retirement allowances. The retirement credit bonus increases the amount of a retired worker's annual allowance. The increase in pension wealth from the retirement credit bonus is the difference between the present value of the allowance with and without the retirement credit bonus. To illustrate this, the following example computes the change in pension wealth for a representative state employee with characteristics that are similar to the average active SERS member as well as the increase in pension liabilities to SERS.

Demographic characteristics and the average salary of active SERS members were obtained from the most recent State Retirement System Actuarial Valuation Report (AVR).[15] The "as of" date of the most recent AVR is January 1, 2021. The AVR reports that the average age of active SERS members is 46.9 years and the average years of creditable service is 12.3. In this example, the representative state employee is assumed to be 47 years old and have 12 years of creditable service as of January 1, 2021. Age and creditable service were rounded to the nearest whole number to simplify the presentation of the results. The representative state employee earns $75,108. This is the the same as the average annual salary of an active SERS member as reported in the AVR. The valuation model assumes that the representative state employee retires at age 62, which is near the average state employee retirement age. Upon reaching 62, the representative state employee will have 27 years of creditable service.

This may lead to situations in which the value of the retirement credit bonus for highly-paid workers with relatively modest exposure to COVID is several times higher than that received by lower-paid front-line workers.

The calculation of the present value of future pension allowances requires an assumption about the rate at which individuals discount future income. All else equal, a cash payment received today is more valuable than the same amount received at a future date. The model assumes that SERS members discount future pension allowances at a rate of 5.5 percent per year. Pension payments are contingent on the survival of the retiree. The valuation model accounts for the survival probability of the representative employee using the same mortality tables as used by PERAC's actuaries.

A technical appendix at the end of this policy brief provides additional detail regarding the derivation and sources for model assumptions. The technical appendix also contains sample calculations regarding the value of the retirement credit bonus for the representative state employee.

Earnings are one of the inputs used to calculate allowances for retired state employees. The average annual earnings of the representative state employee in the three years prior to retirement is $127,550. Readers should note that these are earnings projections for 2033 to 2035 when our representative employee will be between the ages of 59 and 61. The higher average salary reflects both inflation and real income growth over time. If the representative employee were not eligible for the bonus, her retirement allowance would be 59.4 percent of pre-retirement average annual earnings or $75,764.

The Acts allow our representative employee to add three years to either her age or creditable service at retirement. If age is increased by three years the retirement allowance would be 67.5 percent of regular compensation in the three highest years or $86,096, which translates to an increase in the pension allowance in the first year of $10,332. If three years are added to creditable service, the percentage increases to 66 percent and the allowance to $84,183. Clearly, our representative employee would prefer to add three years to her age rather than her creditable service. In present value terms, the value of the additional benefit allowance from the retirement credit bonus for the representative state employee is $55,364.

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It is useful to compare the increase in pension wealth from the retirement credit bonus to the representative employee's annual earnings and to the size of awards in other bonus programs. As discussed above, her 2021 earnings are assumed to be $75,108. The $55,364 increase in pension wealth is 74 percent of her 2021 earnings.[16] Thus, the increase in pension wealth from the retirement credit bonus is about equal to nine months salary. If one considers the March 10, 2020 to December 31, 2020 period the Acts are intended to reward is less than a year — just 297 days — the value of the retirement credit bonus is nearly as large as the representative employee's regular earnings during that time period. .

The value of the retirement credit bonus stands out when compared to the size of bonuses awarded to other state and local government employees during the pandemic. To reiterate a previous example, Department of Corrections employees who performed duties on site during the pandemic received bonuses between $1,000 and $2,000. Corrections facilities are densely populated and corrections officers are often required to be in situations that bring them into contact with inmates. These aspects of work in detention facilities exposed corrections officers to elevated levels of risk from COVID. Given that the retirement credit bonus has wide eligibility, the extension of a retirement credit bonus 28 to 55 times more valuable than the cash bonuses provided to corrections officers appears disproportionate.

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The valuation model for the representative employee can also be used to develop a rough estimate of the effect of the retirement credit allowance on total SERS pension liability. Public pension funds use the estimated return on investments to discount their future pension obligations.[17] The discount rate used by PERAC to compute SERS pension liabilities is higher than the 5.5 percent discount rate used in the valuation model for the representative employee. Currently, PERAC assumes a 7.0 percent return on pension assets. Assuming a discount rate of 7.0 percent, the value of the retirement credit bonus for the representative SERS member is $39,679. The 2021 AVR reports that there were 87,136 active SERS members. Assuming that half of SERS members are eligible for the bonus, the additional liability is about $1.73 billion.[18]

SERS is one of many state and local retirement systems in the Commonwealth. There are over 100 local retirement systems beyond the state employees and teachers systems. Many local plans have large funding shortfalls. As the Acts also apply to teachers and other local government employees, the total cost to all Massachusetts public pension systems would be several times larger than the cost to the SERS alone. The great potential costs underscore the need for a thorough actuarial analysis of the effect of the retirement credit bonus on state and local retirement systems *before* legislative action on the Acts.

Poor Targeting of the Retirement Credit Bonus

For a bonus plan to incent or reward performance, rewards to the employee should be tied either to the value of the work performed, the risks assumed, or both. The value to the public of many types of services during a pandemic or emergency are greater than in normal times. Targeted bonus and performance pay systems recognize that differential. As discussed above, the retirement credit bonus as specified in the Acts is not based on either the value of the employee's services during the pandemic and only tangentially related to the risks assumed. The result is significant inequities in the value of the retirement bonuses for eligible employees.

The retirement credit bonus as specified in the Acts is not based on either the value of the employee's services during the pandemic and only tangentially related to the risks assumed.

To illustrate these inequities, consider the increase in pension wealth from the retirement credit bonus for three hypothetical SERS members. Each of the hypothetical employees is 47 years old and had 12 years of creditable service as of January 1, 2021. The three differ in only two ways: the degree to which work outside the home exposed them to COVID-19 and their current salary.

The first hypothetical SERS member is a healthcare worker in a state-run retirement home, specifically a Nursing Assistant IV at the Holyoke Soldiers' Home. Retirement homes figured prominently in early COVID outbreaks and the COVID outbreak at the Holyoke Soldiers' Home was particularly severe. The legislature's report regarding the events there cited the difficult working conditions for employees during the outbreak.[19] This hypothetical state employee had a high level of risk of exposure to COVID in the workplace. The average base salary of a Nursing Assistant IV at the Holyoke Soldiers' Home is $54,841.[20]

The second hypothetical SERS member is a member of the General Court who earns $85,000 a year.[21] Members may have performed duties outside their homes between March 10, 2020 and December 31, 2020, which qualify them for the retirement credit bonus. This might have involved work at the State House or in legislative districts. The Massachusetts Legislature did not adopt emergency rules that provided for remote sessions until May 2020.[22] The hypothetical member may have had to travel to the State House or state offices to conduct legislative business or performed constituent service outside his home. Nevertheless, the risk of exposure to COVID for a state legislator was almost certainly less than the risk to a Nursing Assistant IV in the Holyoke Soldiers' Home.

The third hypothetical SERS member is a senior administrator of a community college or state university. Public college and university campuses were beginning to transition from in-person to remote learning between March 2020 and December 2020. As a result, work performed by this administrator on campus or elsewhere outside her home likely involved relatively lower levels of potential exposure to COVID than frontline healthcare workers, for example. The 2021 salary of the hypothetical administrator is $200,000.

Table 1 shows the increase in pension wealth for each of these three hypothetical individuals. In each case, the increase in pension wealth is 74 percent of their 2021 salary. That the increase is the same relative to regular earnings for each is not surprising; the Acts merely require that an individual worked or volunteered to work outside his or her home to qualify for the retirement benefit credit. Each employee had duties that required him or her to perform duties outside the home. The Acts make no further distinction among eligible employees in terms of the extent or duration of their potential exposure to COVID. As each of the three is assumed to have the same age and years of creditable service and to retire at age 62, the sole difference between the three in the computation of retirement allowance is regular compensation. The increase in pension wealth of our college administrator, who had the least exposure to COVID but the highest salary is several times that of the nursing assistant who had a substantial risk of contracting COVID while caring for elderly veterans. By failing to account for differences in risk exposure or the nature of work performed during the pandemic, the retirement credit bonus results in serious inequities among eligible employees.

Table 1: Increase in Pension Wealth from the Retirement Credit Bonus
Each hypothetical SERS member is 47 years of age, has 12 years of creditable service, and retires from state service at age 62. The three hyothetical members only differ by potential COVID exposure during the state of emergency and regular compensation.

Job of the Hypothetical Employee	COVID exposure [a]	Regular Compensation in 2021 [b]	Increase in Pension Wealth [c]	Increase in Pension Wealth Relative to Regular Compensation [d]
1. Nursing Assistant: IV at the Holyoke Soldiers' Home	HIGH	$54,851	$40,431	74%
2. Member of the Massachusetts Legislature	MODERATE	$85,000	$62,655	74%
3. Senior College or University Administrator	LOW	$200,000	$147,424	74%

Notes: [d]=[c]/[b]

The retirement credit bonus is also poorly targeted because the increase in pension wealth of eligible employees is a function of earnings and service over one's entire career, not just during the pandemic. As a result, individuals who performed the same tasks and had the same exposure to COVID during the pandemic may experience widely different increases in pension wealth from the retirement credit bonus. Consider four hypothetical SERS members. All four are 47 years old and have a 2021 salary of $75,108. Each worked or volunteered to work outside the home during the pandemic and had the same level of exposure to COVID while on the job. The only difference is their career paths.

The first is our representative employee. He had 12 years of creditable service on January 1, 2021 and retires from state service upon reaching age 62.

The second hypothetical SERS member is a new hire who entered state service on January 1, 2020, just before the pandemic, and retires from state service upon reaching age 62.

The third hypothetical SERS member is a relatively new hire who entered state service on January 1, 2016 and retires from state service upon reaching age 62.

The fourth is a state employee with 12 years of creditable service on January 1, 2021 who will leave state service at the end of 2021.

Table 2 contains estimates of the increase in pension wealth for each of these hypothetical SERS members. All four are eligible to receive the bonus, are the same age, and have the same compensation.[23] The value of the retirement credit bonus differs substantially among the four.

Table 2 illustrates how differences in career path impact the value of the retirement credit bonus. One might expect that the value of the bonus for employee number four who leaves state service at the end of 2021 is less than that of employee number one, who remains in state service through retirement. However, the value of the retirement credit bonus to the hypothetical employees number two and three seem high relative to employee one. Employee two, the new hire, will only have accrued 16 years of creditable service by retirement, whereas employee one will have 27 years. Though employee two has only 60 percent as much time in state service, the value of the retirement credit bonus to that individual is 86 percent of that of employee one.

Even more curious is the value of the retirement credit bonus to employee three. Though employee three would retire with fewer years of service, the value of the retirement credit bonus for employee three is $3,846 greater than for the more senior employee one. All else equal, public sector compensation systems generally provide greater rewards, or at least no lesser reward, to employees with more seniority. With the retirement credit bonus, the result could be the reverse.

Table 2: Increase in Pension Wealth as a Function of Career Path
Each hypothetical SERS member is 47 years of age and has earnings of $75,108 in 2021.
Each has the same level of COVID exposure. The four hypothetical members only differ only by career path.

Career Path of the Hypothetical Employee	Current Regular Compensation [a]	Increase in Pension Wealth [b]	Increase in Pension Wealth Relative to Regular Compensation [c]
1. Base Case: Employee with 12 years creditable service who remains in state service through age 61 and retires at age 62.	$75,108	$55,364	74%
2. Employee starts on January 1, 2020 and remains in state service through age 61 and retires at age 62.	$75,108	$47,368	63%
3. Employee starts on January 1, 2016 and remains in state service through age 61 and retires at age 62.	$75,108	$59,210	79%
4. Employee with 12 years creditable service that leaves state service at the end of 2021 and begins receiving a pension at age 62.	$75,108	$25,377	34%

Note: [c] = [b]/[a]

The apparent bias in favor of more recent hires is due to changes that were made to the retirement percentage schedule as part of the Pension Reform Act of 2011. The law introduced a new schedule that compressed the relationship between age and retirement percentage. For employees hired before April 2, 2012, the percentage point increase in the retirement allowance for each additional year of age is 0.1 times the number of years of service. That is, for a retiree with 20 years of creditable service, each additional year of age at retirement would increase their retirement allowance by 2 percent (20 times 0.1) of their regular compensation. For employees hired on or after that date, the increase is 0.15 percentage points times the number of years of creditable service. The new hire would have his allowance increased by 3 percent (20 times 0.15) of his regular compensation. As a result, the provision in the Acts that allows eligible retirees to add three years to their age is more valuable to new hires than for more senior employees.

The point of these examples is to show that the value of the retirement credit bonus is disconnected from the value of services performed and the risks assumed during the pandemic. That the value of the retirement credit bonus is determined by factors outside the pandemic period results in significant inequities. The value of the retirement credit bonus is significantly greater for highly-paid employees who bore relatively little additional risk from working outside the home than for lower-paid employees who performed tasks that involved greater exposure to individuals who may be infected with the COVID virus.

The value of the retirement credit bonus also depends on career decisions made by employees outside the pandemic period. Though the focus above has been on seniority, one could also argue that the retirement credit bonus creates inequities by providing a more valuable reward to employees who remain with the state versus those who leave state service (employee four in Table 2 versus employee one). This could also be viewed as an inequity since by assumption each performed the same tasks and which entailed the same risks during the pandemic. Given these inequities, and the retirement credit bonus's high cost to taxpayers, legislators should scrutinize the Acts carefully.

Though the focus above has been on seniority, one could also argue that the retirement credit bonus creates inequities by providing a more valuable reward to employees who remain with the state versus those that leave state service.

Additional Problems with the Retirement Credit Bonus

This section discusses three additional shortcomings with the retirement credit bonus program.

First, the Acts set forth only vague eligibility requirements. Section 2(a) implies broad eligibility, referring to "all employees who have volunteered to work or who have been required to work at their respective worksites or any other worksite outside of their personal residence during the COVID-19 state of emergency." The Acts do not define essential employees or require that the employee needed to perform in a clearly defined essential role during the pandemic period. The Acts do not require that the employee spend a specific portion of the time between March 10, 2020 and December 31, 2020 on worksites outside her personal residence. This raises the question of whether a single day on a worksite outside the home would be sufficient to trigger eligibility. A reasonable reading of the language in the Acts suggests that an employee need only have volunteered for such an assignment, not actually performed any work outside her home during this period.

This raises the question as to whether a single day on a worksite outside of the home would be sufficient to trigger eligibility.

The use of March 10, 2020 for the beginning of the eligibility period also raises practical difficulties. Large numbers of state workers could be considered to have worked outside their personal residences after March 10, 2020 because many units of state government didn't shift to remote work until after that date. Governor Baker's initial stay-at-home order for executive branch employees specified that employees should not report to their worksites beginning on March 16, 2020 — five days after the beginning of the eligibility period specified in the Acts.[24] University of Massachusetts campuses did not shift to remote learning until March 16, 2020.[25] As discussed earlier, the General Court did not shift to remote sessions until May 2020 although both the House and Senate had not been in formal session since the onset of the pandemic. By defining the eligibility period to begin on March 10, 2020 and not setting a minimum threshold for the portion of the eligibility period that workers needed to be at worksites outside their homes, the Acts open the door to extending retirement credit bonuses to large numbers of public sector employees who experienced minimal potential exposure to COVID from work outside the home during the pandemic.

The use of vague eligibility requirements may be acceptable when the value of a bonus is modest. This is not the case for the retirement credit bonus. The increase in pension wealth for the typical state employee is over $50,000. The high stakes create strong incentives for employees to embellish or misrepresent the work they performed during the eligibility period to enhance their pensions. The potential for fraud is particularly high in the case of the retirement credit bonus as the Acts specify that merely volunteering to work outside the home is sufficient to trigger eligibility. Many personnel administrators may not have foreseen the need to record voluntary offers of service. Some employees may have false memories of offers that did not occur. Additionally, the shift to remote work in many settings made it difficult for managers and personnel administrators to monitor and verify where employees performed their duties. The high potential for fraud suggests that administrative costs associated with the retirement credit bonus would be substantial.

Second, the retirement credit bonus has weak incentive effects. It is unlikely that the retirement credit bonus could have provided an incentive for public sector employees to assume extra duties during the pandemic because information regarding the possibility of a pension bonus only became available after the end of the eligibility period. The Acts specify that to become eligible one had to volunteer to or actually work outside the home between March 10, 2020 and December 31, 2020. However, legislation to establish the retirement credit bonus was initially filed in 2021.[26] By that point the eligibility period had ended. The proposed legislation is thus is an ex post facto reward rather than incentive. The American Action Forum examined the use of hazard pay by state and local governments.[27] None of the hazard pay systems identified in their research involved enhancements to employee pensions.

It is unlikely that the retirement credit bonus could have provided an incentive for public sector employees to assume extra duties during the pandemic because information regarding the possibility of a pension bonus only became available after the end of the eligibility period.

The high cost of the bonus—several billion dollars—and the precarious state of pension funding in Massachusetts suggests that the retirement credit bonus is a one-time event. To the extent that public sector employers in Massachusetts wish to provide a financial reward to essential workers for past efforts during the pandemic, a standard cash bonus arrangement that links the value of the award to the amount of work performed and hazards assumed would be more appropriate. The cost to the employer of the bonus program should be small enough that there is a reasonable expectation that the employer will have the financial wherewithal to provide similar bonus payments in future emergencies.

Third, the Acts do not address the treatment of certain groups of public sector employees who may be ineligible for the retirement credit bonus. For instance, the Acts do not provide a bonus of any sort to shorter-tenured employees who do not meet plan vesting retirements. Most public employee retirement plans in Massachusetts require that an employee accrue at least 10 years of full-time service to become eligible for a retirement allowance. The Acts do not provide for any form of additional payments for individuals who leave the public sector before vesting. The Acts also create ambiguities regarding the treatment for vesting purposes of individuals with more than seven but less than ten years of service. The Acts state that three years may be added to the employee's years of service "for the purpose of calculating a retirement benefit". However, the Acts do not address whether three years may be added to the creditable service of an individual for the purpose of satisfying vesting requirements. The Acts do not address the treatment of individuals whose existing combination of age and years of service already renders them eligible to retire with a full pension. Chapter 32, Section 5 of the Massachusetts General Laws caps retirement allowances at 80 percent of a retiree's average annual rate of regular compensation prior to retirement. Presumably these individuals would not receive an increase in their retirement allowance even if their roles involved work outside the home during the pandemic period.

Conclusion

Massachusetts lawmakers are considering legislation that would enhance the retirement allowances of a large number of state and local government and other public employees. The value of the retirement credit bonus to eligible employees is significant — equal to about nine months earnings for the typical state employee. Enactment of the retirement credit bonus would add several billion dollars to the liabilities of Massachusetts state and local public pension funds. Before legislative action is taken on either H.2808 or S.1669, thorough actuarial valuation analyses should be completed to assess the impact of the retirement credit bonus on every public pension plan in Massachusetts.

Enactment of the retirement credit bonus would add several billion dollars to the liabilities of Massachusetts state and local public pension funds.

Prudence also dictates that when lawmakers enact legislation that places a significant financial burden on future taxpayers, they must take care to ensure that legislation effectively advances sound public policy goals. H.2808 and S.1669 fail that test.

The retirement credit bonus scheme, as set forth in the Acts, would result in significant inequities among eligible employees. The value of the retirement credit bonus does not reflect the type of work performed or the risks assumed by a public sector employee during the pandemic. Rather, the value of the retirement credit bonus is a function of the standard factors used to determine retirement allowances. Employees in positions that are lower paid but entailed substantial risk of exposure to COVID receive bonuses that are far less valuable than employees in highly-paid positions for which on-site work involved minimal exposure to the virus. The use of a retirement bonus to reward workers also results in situations in which workers who performed the same tasks and incurred the same amount of risk of exposure to the virus during the pandemic receive bonuses that differ significantly in value simply because their career paths differ. In other cases, the retirement credit bonus scheme creates inequities by advantaging some relatively new hires, who joined after the 2011 pension reforms, over longer-term employees.

The retirement credit bonus as set forth in the Acts has weak incentive effects. As such, it serves as a reward rather than an incentive. The prospect that on-site work would be rewarded through an enhanced retirement allowance only became a possibility after the eligibility period designated in the Acts had expired. Moreover, the high cost of the bonus as envisioned by the Acts suggests that a similar bonus scheme is unlikely to be repeated in the future.

Finally, given the vague eligibility requirements set forth in the Acts and the high value of the bonus to eligible employees, the retirement credit bonus creates substantial incentives for the embellishment or misrepresentation of service records to gain access to a larger retirement allowance. Fraud and misrepresentation drive up administrative costs and create inequities within the public sector workforce by providing greater rewards to those who are better at gaming the system.

Technical Appendix: Model Assumptions and Representative Employee Model Calculations

Representative Employee Salary and Demographics: The characteristics of the representative state employee are based on the average earnings, age and years of creditable service of active SERS members as reported in the most recent valuation report.[28] As of January 1, 2021 the average age of active SERS members was 46.9 years, the average years of creditable service was 12.3 years, and the average salary was $75,108. To simplify the presentation of the results, age and years of creditable service are rounded to the nearest whole number. The representative state employee is assumed to be 47 years of age and have 12 years of creditable service as of January 1, 2021. The salary of the representative state employee of $75,108 in 2021 is the same as the average salary of an active SERS member.

Group Code: The pension benefit formula depends on the employee's group. Group 1 is the broadest and most numerous of the four groups of SERS members. The valuation model assumes that representative employee is a member of Group 1. Group 1 consists of general employees, including clerical, administrative, technical and all other employees not elsewhere classified. Members of Groups 2, 3 and 4 are employees involved in public safety, corrections, courts and other hazardous duty positions.

Age at Retirement: The representative employee is assumed to retire upon reaching age 62. This is slightly higher than the average retirement age of SERS members assumed by PERAC's actuaries. Based on age and retirement propensity tables appearing in the 2021 AVR, the weighted average retirement age of males in Group 1 is 61.67 years and females in Group 1 is 61.37 years. The results are not qualitatively different when the present value of retirement benefits is computed assuming that the representative employee retires at age 61.

Payment Type: SERS members may receive their retirement allowance in three different forms. The representative employee is assumed to select option A in which the retirement allowance is paid beginning on the date of retirement and terminates on the date of the member's death. This is the most popular retirement option among SERS members.[29] Options B and C provide payments to a beneficiary upon the death of the SERS member. The difference in retirement allowance between options A and option B and C is not large enough to qualitatively affect the results. The Massachusetts State Retirement Board reports that retirees choosing option B have allowances between 1 and 5 percent lower than option A and those choosing option C have allowances 7 to 15 percent less than option A.[30] While the selection of options B and C lower the allowance received by the retiree, the payments received by beneficiaries following the death of a retiree also have value for plan members.

COLA: Massachusetts Law allows a cost-of-living allowance (COLA) to be applied to the first $13,000 of a pension allowance. The model assumes no change to the COLA limit in the future. The COLA only affects an employee's pension wealth if the allowance at retirement without the retirement credit bonus is less than $13,000. In each case considered in this policy brief, the retirement allowance without the retirement credit bonus is greater than $13,000. As a result the COLA does not enter into the calculations.

Mortality: Mortality assumptions in the SERS AVR are based on the Society of Actuaries' RP-2014 mortality tables. PERAC uses the RP-2014 Blue Collar Employees table for active members and the RP-2014 Blue Collar Healthy Annuitant table for retirees. Survival probabilities in the model are taken from the RP-2014 tables. PERAC makes an additional adjustment to mortality rates for females. To avoid complex adjustments to mortality rates that would make the computations less transparent, no further adjustments are made to the mortality rates in the RP-2014 tables. The model assumes that the set of employees eligible for the retirement credit bonus will be equally distributed between males and females. Therefore, the survival probabilities for the representative employee is the average of male and female survival probabilities from the RP-2014 tables. The assumed gender distribution is close to the actual distribution of state employees. The Massachusetts Employee Diversity Dashboard indicates that 52 percent of full-time state employees were female and 48 percent were male as of 4Q 2020.[31] The AVR does not report the mix of active SERS members by gender.

Discount Rate: The valuation model assumes that the representative employee discounts future pension payments using a discount rate of 5.5 percent per year. The discount rate accounts for both future changes in the price level and the rate at which the representative employee discounts future consumption. The inflation rate is assumed to be 2.5 percent each year in the future. This is slightly higher than the 2.4 percent inflation rate used by the Social Security Administration in its intermediate case long-term economic projections.[32] The discount rate also accounts for the rate at which individuals discount future consumption. This is often referred to as the social rate of time preference. Time preference varies among individuals with some discounting the future at higher rates (less patient) while others discount at lower rates (more patient). The Office of Management and Budget recommends the use of 3.0 percent as the rate at which individuals discount future consumption.[33] The OMB discount rate is based on historical pre-tax returns on ten-year Treasury securities net of change in the consumer price index. Since the 2008 financial crisis yields net of expected inflation on ten-year Treasury securities have been lower than 2.0 percent. As a result, the OMB discount rate on future consumption may be above that which is appropriate given current economic conditions. The use of a lower discount rate consistent with recent yields on Treasury securities would result in a higher value for increase in pension wealth from the retirement credit bonus. The discount rate on pension allowances of 5.5 percent is the sum of the inflation rate assumption (2.5 percent) and the rate at which the representative employee discounts future consumption (3.0 percent).

Appendix Table 1: Increase in Pension Wealth from the Retirement Credit Bonus for the Representative SERS Member

Member remains on state payroll until retirement at age 62. The retirement allowance at age 62 with 27 years of service is 59.4 percent of the member's average annual earnings in their three highest years. The retirement credit bonus increases the age at retirement by three years to age 65 for the purpose of calculating the retirement allowance. The retirement allowance at age 65 for an individual with 27 years of service is 67.5 percent of their pre-retirement earnings.

Year [a]	Age [b]	Creditable Service at Year-end [c]	Earnings Growth [d]	Regular Earnings [e]	Increased Pension from the Retirement Credit Bonus [f]	Survival Probability [g]	Discount Factor [h]	PV of Annual Benefit [i]
2021	47	13		75,108		1	1	
2022	48	14	4.50%	78,488		0.999	0.948	
2023	49	15	4.50%	82,020		0.997	0.898	
2024	50	16	4.25%	85,506		0.995	0.852	
2025	51	17	4.25%	89,140		0.993	0.807	
2026	52	18	4.25%	92,928		0.991	0.765	
2027	53	19	4.25%	96,878		0.989	0.725	
2028	54	20	4.00%	100,753		0.987	0.687	
2029	55	21	4.00%	104,783		0.984	0.652	
2030	56	22	4.00%	108,974		0.981	0.618	
2031	57	23	4.00%	113,333		0.978	0.585	
2032	58	24	4.00%	117,866		0.974	0.555	
2033	59	25	4.00%	122,581		0.970	0.526	
2034	60	26	4.00%	127,484		0.966	0.499	
2035	61	27	4.00%	132,584		0.961	0.473	
2036	62				10,332	0.953	0.448	4,412
2037	63				10,332	0.945	0.425	4,145
2038	64				10,332	0.936	0.402	3,890
2039	65				10,332	0.926	0.381	3,648
2040	66				10,332	0.915	0.362	3,418
2041	67				10,332	0.903	0.343	3,198
2042	68				10,332	0.891	0.325	2,989
2043	69				10,332	0.877	0.308	2,790
2044	70				10,332	0.862	0.292	2,600
2045	71				10,332	0.846	0.277	2,419
2046	72				10,332	0.829	0.262	2,246
2047	73				10,332	0.810	0.249	2,081
2048	74				10,332	0.790	0.236	1,924
2049	75				10,332	0.769	0.223	1,774
2050	76				10,332	0.746	0.212	1,631
2051	77				10,332	0.721	0.201	1,495
2052	78				10,332	0.695	0.190	1,365
2053	79				10,332	0.666	0.180	1,241
2054	80				10,332	0.636	0.171	1,123
2055	81				10,332	0.605	0.162	1,012
2056	82				10,332	0.571	0.154	906
2057	83				10,332	0.536	0.146	806
2058	84				10,332	0.499	0.138	712
2059	85				10,332	0.461	0.131	623
2060	86				10,332	0.422	0.124	541
2061	87				10,332	0.383	0.117	465
2062	88				10,332	0.343	0.111	394
2063	89				10,332	0.303	0.106	330
2064	90				10,332	0.264	0.100	273
Present Value of Additional Retirement Allowance Between Ages 62 and 90								54,448
Present Value of Additional Retirement Allowance Between Ages 91 and 120 (not shown above)								915
Present Value of Additional Retiement Allowance from the Retirement Credit Bonus								55,364

Notes:
[f]: Average earnings in 2033, 2034 and 2035 times (0.675-0.594)
[i]: [[f] x [g] x [h]
[h]: 1.055^-([c]-13])
Sources:
[d]: Actuarial Valuation Report
[g] Society of Actuaries RP-2014 Mortality Tables

Endnotes

1 An Act Relative to Providing a COVID-19 Retirement Credit to Essential Public-Sector Workers, H.2808, 192nd General Court.

2 An Act Relative to Providing a COVID-19 Retirement Credit to Essential Public-Sector Workers, S.1669, 192nd General Court.

3 Contribution rates for existing members of public pension systems in Massachusetts are based on the date of hire. Because contribution rates for existing members are frozen the burden of funding the retirement credit bonus through additional employee contributions would fall entirely on new hires.

4 https://malegislature.gov/Bills/192/H2808/Cosponsor and https://malegislature.gov/Bills/192/S1669/Cosponsor

5 The Pioneer Institute's MassPensions website contains information on the funding status of every state and local pension plan in Massachusetts. See https://masspensions.com/.

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12 Chapter 124: An Act Making Appropriations for the Fiscal Year 2020 to Authorize certain COVID-19 Spending in Anticipation of federal Reimbursement, 191st General Court. The reserve was created as part of a $1.1 billion supplemental budget for COVID-19 response.

13 Shira Schoenberg, "Some State Workers Get $2,000 Bonus for Pandemic Work," CommonWealth Magazine, August 13, 2021. https://commonwealthmagazine.org/state-government/some-state-workers-get-2000-bonus-for-pandemic-work/

14 Press release, AFSCME Council 93, "Council 93 Human Services Workers in MA Rewarded for Their 'Courage and Dedication' During COVID-19 Crisis," April 12, 2020. https://www.afscme93.org/news/council-93-human-services-workers-ma-rewarded-their-courage-and-dedication.

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16 Retirement allowances are tax advantaged relative to regular earnings. Accounting for the effect of taxes, the present value of the retirement credit bonus would be greater than 74 percent of the representative employee's earnings. Retirement allowances for public sector employees are not subject to Massachusetts income taxes whereas earnings of active state employees are taxed. Pension contributions are also deducted from the earnings of active state employees but not retirees.

17 The analysis in this section leaves aside the question of whether the assumed rate of return on pension fund assets is an appropriate discount rate to apply to public pension liabilities. An extensive economics and practitioner literature suggests that the assumed rate of return is too high and results in understatement of the true value of public pension plan liabilities. See, for instance, Jeffrey R. Brown and David W. Wilcox, 2009, "Discounting State and Local Pension Liabilities," American Economic Review, vol. 99, no. 2, (May) pp. 538-542; also Robert Novy-Marx and Joshua Rauh, 2011, "Public Pension Promises: How Big Are They and What Are They Worth?," The Journal of Finance, vol. 66, no. 4, (August), pp. 1211-1249.

18 The Franklin Regional Retirement System estimates that half of their members would be in the essential workers category based on the list of essential services appearing in Governor Baker's March 23, 2020 order. Franklin Regional Retirement System, "Letter to Senators Adam G. Hinds and Joanne M. Comerford and Representatives Susannah M. Whipps, Paul W. Mark and Natalie M. Blais," March 31, 2021. http://www.frrsma.com/wp-content/uploads/2021/02/FRRS-letter-re-retirement-credit-to-essential-public-sector-workers.pdf.

19 Massachusetts General Court," Report of the Special Joint Oversight Committee on the Soldiers' Home in Holyoke COVID-19 Outbreak: Findings & Recommendations," May 2021. https://www.nepm.org/sites/wfcr/files/202105/05-24_Holyoke_Special_Committee_Final_Report.pdf.

20 Salary information was obtained from the CTHRU database. Commonwealth of Massachusetts, Office of the Comptroller, CTHRU, online database. https://www.macomptroller.org/cthru.

21 Members of the General Court receive several forms of compensation. The base pay of a member is $70,536 in 2021. However, members also receive additional compensation for holding leadership and committee positions. The three members who sponsored H.2808 and S.1669 together earn additional compensation of at least $56,000 from service as chairpersons of two committees and as vice-chairs of five committees. When earnings from committee positions are considered the average 2021 regular earnings of the three sponsors is at least $89,202.

22 The first remote session of the Massachusetts House of Representatives took place on May 6, 2020 and the first remote session of the Massachusetts Senate was on May 14, 2020.

23 PERAC actuaries assume that the salary growth of active SERS members is a function of their years of creditable service. Employees with less creditable service have larger year-over-year salary increases. To remove the effect of salary growth assumptions on the value of the retirement credit bonus of the four hypothetical employees in Table 2, it is assumed that salary growth for each individual in each calendar year is the same as that of the representative employee in the base case.

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33 Office of Management and Budget, "Circular A-4," September 13, 2003. https://obamawhitehouse.archives.gov/omb/circulars_a004_a-4/

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